SCAC MEETING AGENDA
Friday, November 1, 2024
In Person at the TAB Building
502 E. 11th St., Suite 200
Austin, TX 78701

FRIDAY, November 1, 2024:

I. WELCOME FROM CHIP BABCOCK

II. STATUS REPORT FROM JUSTICE BLAND

Justice Bland will report on Supreme Court actions and those of other courts related to the Supreme Court Advisory Committee since the August 16, 2024 meeting.

III. THIRD PARTY LITIGATION FUNDING

1-14c Subcommittee:
Hon. Harvey Brown – Chair
John Kim – Vice Chair
Connie Pfeiffer
Marcy Greer

A. October 28, 2024 Memo re: Proposed Rule Requiring Disclosure of Third-Party Funding

IV. ARTIFICIAL INTELLIGENCE

1-14c Subcommittee:
Hon. Harvey Brown – Chair
John Kim – Vice Chair
Connie Pfeiffer
Marcy Greer
Hon. John Browning (on subcommittee for this topic)
Robert Levy (on subcommittee for this topic)

B. Taskforce for Responsible AI in the Law Interim Report
C. August 8, 2024 Memo re: Potential Rule Amendments to Address Artificial Intelligence
D. August 6, 2024 Memo from Family Law Council, Executive Committee re: Proposed Changes to TRCP 13 & TRE 901
E. October 17, 2024 Memo re: 226a amendment to reflect current technology and Generative AI
F. October 1, 2024 Memo from Fordham University re: AI and Possible Amendments to the FRE
G. October 28, 2024 Memo re: Update on Potential Rule Amendments to Address AI

V. RECORDING AND BROADCASTING COURT PROCEEDINGS

15-165A Subcommittee:
Richard Orsinger – Chair
Hon. Ana Estevez – Vice Chair
Prof. Elaine Carlson
Prof. William Dorsaneo
John Kim
Hon. Emily Miskel
Giana Ortiz
Pete Schenkkan
Hon. John Warren

H. November 9, 2021 Subcommittee 1's Report and Recommendations
I. August 12, 2024 Memo re: TRCP 18c
J. October 31, 2024 Memo re: TRCP 18c
K. Draft 18c Recording and Disseminating Court Proceedings
L. Proposed Changes to 18c
M. August 6, 2024 Memo from Family Law Council, Executive Committee re: Proposed Rule Changes by the Texas Supreme Court
N. August 6, 2024 Memo from Family Law Council, Executive Committee re: TRCP 18C
    1. 2023 Broadcasting Brief

VI. TRANSFER ON DEATH DEED FORMS

300-330 Subcommittee:
Lamont Jefferson – Chair
Charles "Skip" Watson – Vice Chair
Prof. William Dorsaneo
Hon. R.H. Wallace
Hon. Sharena Gilliland

O. February 2, 2024 Letter from Probate Forms Task Force
P. 84th Legislative Session Handout re: TODD
Q. TODD Q&A

VII. ERROR PRESERVATION CITATIONS

Appellate Subcommittee:
Hon. Bill Boyce – Chair
Connie Pfeiffer – Vice Chair
Prof. Elaine Carlson
Prof. William Dorsaneo
Hon. David Keltner
Rich Phillips
Macey Reasoner Stokes
Charles "Skip" Watson

R. October 29, 2024 Memo re: Proposed Response to State Bar Rule Committee's 2015 Suggestion
S. State Bar Court Rules Committee Proposed Changes to TRAP 9.4, 38.1, and 38.2

VIII. COURTS OF APPEALS OPINIONS

Appellate Subcommittee:
Hon. Bill Boyce – Chair
Connie Pfeiffer – Vice Chair
Prof. Elaine Carlson
Prof. William Dorsaneo
Hon. David Keltner
Rich Phillips
Macey Reasoner Stokes
Charles "Skip" Watson

T. August 1, 2024 Memo re: Proposal Regarding Publication of Court of Appeals Opinions

IX. TEXAS RULE OF APPELLATE PROCEDURE 18.1

Appellate Subcommittee:

Hon. Bill Boyce – Chair
Connie Pfeiffer – Vice Chair
Prof. Elaine Carlson
Prof. William Dorsaneo
Hon. David Keltner
Rich Phillips
Macey Reasoner Stokes
Charles "Skip" Watson

U. October 29, 2024 Memo re: Proposed Amendments to TRAP 18.1(a)
V. State Bar for Texas Court Rules Committee Proposed Amendments TRAP 18.1(a)

X. PROCEDURAL RULES FOR THE STATE COMMISSION ON JUDICIAL CONDUCT

Judicial Subcommittee:
Hon. Bill Boyce – Chair
Kennon Wooten – Vice Chair
Hon. Nicholas Chu
Hon. Tom Gray
Michael Hatchell
Prof. Lonny Hoffman
Macey Reasoner Stokes
Hon. Maria Salas-Mendoza

W. September 16, 2024 Referral letter from Supreme Court of Texas
X. October 31, 2024 Memo re: Revisions to Procedural Rules for the SCJC
Y. Procedural Rules for the SCJC
Z. 2023 SCJC Annual Report

XI. TEXAS RULE OF CIVIL PROCEDURE 4

1-14c Subcommittee:
Hon. Harvey Brown – Chair
John Kim – Vice Chair
Connie Pfeiffer
Marcy Greer

AA. June 5, 2024 Email from V. Katz re: TRCP 4
BB. August 6, 2024 Memo from TRCP 1-14c Subcommittee re: Final Rule 4 Proposal

Tab A

MEMORANDUM

To: Texas Supreme Court Advisory Committee (SCAC)

From: Rules 1-14c Subcommittee

Re: Rule requiring disclosure of third-party financing

Date: October 28, 2024

I. Evaluation of a rule requiring TPLF Disclosure

In response to the Supreme Court's July 17, 2024 referral letter, the Rules 1-14c Subcommittee reviewed and discussed the topic of Third Party Litigation Funding (TPLF). After a spirited debate, the Subcommittee voted 3:1 to reject a rules amendment that would require disclosure of the existence and content of funding agreements in civil proceedings. A copy of the key materials that our subcommittee considered are attached (members shared numerous additional resources on the topic), including a letter from the International Legal Finance Association (ILFA) and a joint letter from the Texas Civil Justice League, the U.S. Chamber of Commerce Institute for Legal Reform ("ILR"), and Lawyers for Civil Justice ("LCJ").

The Subcommittee also wanted to bring the following related developments to the Committee's attention:

- On October 10, 2024, the Federal Civil Rules Advisory Committee appointed a subcommittee to review and consider rulemaking on TPFL disclosure. The issue has been pending before the Advisory Committee for over a decade.
- The Arizona Supreme Court recently received a report from a twelve-member task force consisting of lawyers, judges, law professors, a member of the public, and various groups as part of its evaluation of Alternative Business Structures (i.e. non lawyer owned legal service providers). The report examined the treatment of TPLF (p. 7-9), gives an overview of TPLF (p. 9-10), and made recommendations (p. 6). The recommendations included judicial training on TPLF and "limited initial disclosure" of the existence of TPLF and the funder but not mandatory disclosure of the agreements through discovery. Instead, it recommended that the civil cover sheet of the lawsuit include a box to indicate whether there was funding in the litigation and the name of the funder so data can be collected regarding TPLF (see recommendation 5). It also discussed "disclosure approaches courts might follow to address the interests and potential conflicts that arise during litigation." *Id*. at 19-20.
- Two Texas courts have concluded that third-party financing agreements in those cases were not usurious and did not violate Texas public policy. *See Anglo-Dutch Petroleum Intern., Inc. v. Haskell*, 193 S.W.3d 87, 104 (Tex. App.—Houston [1st Dist.] 2006, pet. denied) (noting agreements "do not contain provisions permitting appellees to select counsel, direct trial strategy, or participate in settlement discussions" and that plaintiffs solicited the "investments after being unable to obtain a conventional loan because it had inadequate collateral."); *Anglo-Dutch Petroleum Intern., Inc. v. Haskell*, 193 S.W.3d 87, 104 (Tex. App.—Houston [1st Dist.] 2006, pet. denied).

II Proposed Rule Language

Chief Justice Hecht also requested that our Subcommittee draft a potential rule for consideration if the Committee as a whole votes in favor of a disclosure rule.

We offer the following potential amendment to Rule 194.2.

(d) Initial Disclosure regarding Third Party Litigation Funding.

1. Who must file. A nongovernmental plaintiff, counter-plaintiff, or intervenor in any case that is pending in a business court must file with the court a statement (separate from any pleading) that contains the information set forth in section 3 within 30 days of filing an initial petition or counter-claim or transfer of a dispute to a business court. The disclosure statement must be amended within 60 days of any new or corrected information that is required to be disclosed by Section 3.
2. Definitions. A third-party litigation funder (TPLF) is any third-party entity or person other than an attorney or referring attorney in the case that provides financial support to a party in a lawsuit or claim in any Texas court in exchange for a contingent share of the proceeds generated by that litigation, whether by settlement, judgment, or otherwise
3. Contents. The disclosure statement must state whether any TPLF or other third party other than the lawyers in the case has any financial interest of any kind in any of the recovery of any damages, fees, or other relief in this case.

   Alternative 1: If it does, a second disclosure should be submitted to the court *in camera* that identifies the TPLF and provides the court with a copy of the agreement granting or conveying to it an interest in the recovery in this case.

   Alternative 2: If it does, a second disclosure should be submitted to the court that identifies the TPLF and provides a copy of the agreement granting or conveying to it an interest in the recovery in this case.

MEMORANDUM

To: Supreme Court Advisory Committee

From: John H. Kim

Date: October 28, 2024

Re: Proposed Disclosure Rule for Litigation Funding Agreements

As lawyers learned back in law school, litigation should be a level playing field for all of the parties. Courts should resolve lawsuits on their merits, not on the basis of procedural devices that tip the balance in favor of one side over the other.

The Texas Civil Justice League and the US Chamber of Commerce Institute for Legal Reform have long advocated that courts adopt a mandatory discovery rule that would require a plaintiff in any civil lawsuit to disclose (i) the identity of any commercial enterprise that has provided litigation funding in exchange for a contingent interest in the outcome of the lawsuit and (ii) a copy of at least the litigation funding agreement and perhaps other documents as well. Those efforts have largely failed and for good reason. At this point, the most effective policy would be to wait to see if federal legislation or federal courts, where this debate has not only been long but hot, decide whether to adopt such a rule.

Although the CJL and ILR repeatedly proclaim that mandatory disclosures ensure "fairness" and are "impartial," their proposed revisions in fact ensure exactly the opposite. They explicitly seek to tip the balance of fairness in favor of defendants.

Litigation funding can mean many things.

There is nothing particularly new about litigation funding.[1] By definition, litigation funding is simply a means by which a party to a lawsuit receives financing for the lawsuit from a person or entity that is not a party to the lawsuit. An attorney, by paying for expenses under a contingency fee agreement, effectively provides litigation funding to a client.[2] But even when a plaintiff is reluctant to engage an attorney on a contingency basis, a plaintiff may receive litigation funding from any number of sources: parents, friends, banks, or even — as is relevant here — third-party entities in the specific business of offering litigation funding.

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[1] William C. Marra, *What's So New About Litigation Finance*, NYU SCHOOL OF LAW CENTER ON CIVIL JUSTICE SYMPOSIUM, at 83 (2021).

[2] *Id.* ("When a lawyer takes a case on contingency, litigating the case for no up-front charge in exchange for a share of case proceeds, she provides third-party financing.").

Litigation funding is not unique to plaintiffs. Defendants too may receive litigation funding from any number of sources. An employer may pay the legal fees of an employee who is sued for conduct in the course of employment.[3] A parent or affiliated company may pay the legal fees of a single-asset LLC or other entity that lacks sufficient capital to cover the costs of defense. Indeed, a third-party commercial entity — such as, for instance, a surety, a bank, or even a litigation financing company — may agree to pay the legal fees of a corporate defendant in exchange for some form of consideration, such as an ownership interest in the defendant's business or assets.[4]

CJL and ILR's proposed revisions to Rule 194 focus almost entirely on litigation funding to plaintiffs. They largely ignore any litigation funding to defendants.

Notably, Texas has long recognized that plaintiffs generally may not seek discovery as to how a defendant is paying for its attorney's fees.[5] Such discovery is deemed to be irrelevant and an invasion of the work product doctrine — even in cases where the defendant has claimed insolvency and seemingly would be unable to pay its attorney's fees in the absence of any litigation funding.[6] Yet, many of the policy concerns that the CJL and ILR have raised in favor of their proposed revisions to Rule 194 would apply as equally to a defendant as they would to a plaintiff.

More broadly, the arguments for mandatory disclosure of commercial third-party litigation funding to plaintiffs apply equally to *many* of the various other forms of litigation funding, such as contingency fee agreements or reverse contingency agreements. "Just as we have long recognized that mandatory disclosure of these various other forms of arrangements is not necessary, there is no reason to require mandatory disclosure of commercial litigation finance."[7]

What is sauce for the goose must be sauce for the gander. As even some advocates for disclosure of litigation financing agreements have recognized, "the variability of litigation finance

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[3] *Id.* at 83-84 ("When an employer pays the employee's legal fees, or when a parent pays an adult child's divorce costs, the employer and parent provide third-party financing.").

[4] *See, e.g.,* Maya Steinitz, *Follow the Money? A Proposed Approach for Disclosure of Litigation Finance Agreements*, 53 U.C. DAVIS L. REV. 1073, 1089 (2019) (recognizing that litigation financing may be "utilized on both sides of the 'v.'").

[5] *E.g., In re Topletz,* No. 05-20-00634-CV, 2020 WL 6073877, *3-4 (Tex. App.—Dallas Oct. 15, 2020, orig. proceeding); *see MCI Telecommunications Corp. v. Crowley*, 899 S.W.2d 399, 403 (Tex. App.—Fort Worth 1995, orig. proceeding) (holding that if the defendant is not seeking to recover any attorney's fees, the plaintiff may not conduct any discovery *at all* into the defendant's fees, as those fees are "patently irrelevant" and "not reasonably calculated to lead to the discovery of admissible evidence"); *see also In re Texas Mut. Ins. Co.*, 358 S.W.3d 869, 872 n.3 (Tex. App.—Dallas 2012, orig. proceeding) ("When a party does not seek to shift its fees to its opponent, the party's attorney's fees are not subject to discovery because they are 'patently irrelevant'").

[6] *Topletz*, 2020 WL 6073877, at *3-4.

[7] Marra, *supra* note 1, at 93.

scenarios militates against a bright-line approach."[8] That is especially true where, as here, the proposed bright-rule approach would effectively require disclosure only of litigation funding to plaintiffs, not defendants.

Litigation is expensive and necessarily requires funding.

If the CJL and ILR are honest about it, the key motivating factor in their proposed revisions to Rule 194 is that they just do not like the idea that third-party commercial companies can invest in lawsuits by providing funding in exchange for a contingency interest in the outcome from the plaintiff's counsel. CJL and ILR think that such investments smack of champerty. Texas, however, has long since rejected the old English bar against champertous agreements; and especially in Texas, any concern that litigation funding agreements smack of champerty rests on "ancient and transplanted fears."[9]

Third-party commercial litigation funding agreements serve a valid purpose. Lawsuits are expensive.[10] Particularly in disputes against large corporate entities, individual plaintiffs often cannot afford the cost of litigation without some kind of litigation funding. Litigation funding thus "allows lawsuits to be decided on their merits, and not based on which party has deeper pockets or stronger appetite for protracted litigation."[11]

Litigation funding "evens the playing field on an economic level in a way that traditional banking institutions cannot."[12] By providing the necessary financing for litigation, "lawsuit-funding companies help ensure that justice, although blind, is not also a beggar."[13]

CJL and ILR's proposed revisions to Rule 194 are simply a veiled attack on third-party commercial litigation funding. Their attacks are unfair and unfounded. What CJL and ILR really seek to do is to tip the balance in favor of defendants and ensure that litigation remains a place where only the wealthy can play ball.

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[8] Steinitz, *supra* note 4, at 1088.

[9] Christy B. Bushnell, Comment, *Champerty Is Still No Excuse in Texas: Why Texas Courts (and the Legislature) Should Uphold Litigation Funding Agreements*, 7 HOUS. BUS. & TAX L.J. 358, 363 (2007).

[10] *See* Marra, *supra* note 1, at 86 ("Bringing even a straightforward breach of contract claim can cost hundreds of thousands, or even millions, of dollars. Not everyone has that kind of money.").

[11] *Lawsuit Funding, LLC v. Lessoff*, No. 650757/2012, 2013 WL 6409971, *6 (N.Y. Sup. Ct. Dec. 4, 2013); *see* Keith Sharfman, *The Economic Case Against Forced Disclosure of Third Party Litigation Funding,* N.Y. STATE BAR ASS'N, Feb. 11, 2022 ("[L]itigation should always be about the merits themselves, not about which side is better funded or whether one side or the other seems more Goliath- or David-like.").

[12] Bushnell, *supra* note 9, at 364.

[13] *Id.*

The arguments for disclosure are speculative and baseless.

In CJL and ILR's letter to the Committee, their primary argument in favor of their proposed revisions to Rule 194 is that a few other jurisdictions have already required that plaintiffs disclose third-party commercial litigation funding agreements. Texas, however, has never been inclined to adopt any revisions to its rules of civil procedure simply because "that's what other jurisdictions are doing." Indeed, Texas's rules of civil procedure vary substantially from the federal rules and most other states' rules of civil procedure — precisely because Texas has tailored its rules to work in a way that best fits the needs of Texas practitioners and their clients.

CJL and ILR's letter to the Committee offers few, if any, practical reasons for requiring that plaintiffs disclose any third-party commercial litigation funding agreements. To the contrary, their letter relies heavily on speculation. In Texas, of course, speculation is no evidence of anything.[14] Nor does CJL and ILR's speculation have any merit.

First, CJL and ILR say that there is "mounting evidence" that litigation funding companies exercise control and influence over the litigation. But they cite only three examples — all out-of-state cases involving complex commercial issues and hundreds of millions of dollars in potential damages. Extreme examples are never a good justification for imposing blanket rules that would govern *all cases*. And as Texas courts have already recognized, CJL and ILR's extreme examples do not reflect the norm in Texas: most litigation funding agreements do *not* give litigation funding companies any right to control a case by selecting counsel, directing trial strategy, or dictating the terms or amount of any settlement.[15] Regardless, CJL and ILR's speculative fear that litigation funding companies may exercise control or influence over lawsuits is no basis for a blanket rule of disclosure:

- As ethics expert Professor Bradley Wendel has explained, TPLF "does not create any risks for the lawyer-client relationship that cannot be mitigated by the conscientious application of existing state disciplinary rules."[16] In any event, a defendant has no standing to question who is selecting the plaintiff's counsel, directing the plaintiff's trial strategy, or participating in any settlement evaluation for the plaintiff. Those are matters entirely between a plaintiff and her counsel.[17]

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[14] *E.g., Joe v. Two Thirty Nine J.V.*, 145 S.W.3d 150, 164 (Tex. 2004).

[15] *E.g., Anglo-Dutch Petroleum Int'l, Inc. v. Haskell*, 193 S.W.3d 87, 104 (Tex. App.—Houston [1st Dist.] 2006, pet. denied); *see also* Marra, *supra* note 1, at 94 ("Reputable litigation finance companies scrupulously adhere to the ethics rules and do not control litigation.").

[16] Letter from Cornell Associate Dean Bradley Wendel to Secretary of the Committee on Rules of Practice and Procedure, Sept. 27, 2017, at 2.

[17] *See* Sharfman, *supra* note 11 ("If there is an ethical concern about attorneys' fee structures or their arrangements with litigation funders, it is appropriate for their clients but not their adversaries to complain. … [A]dditional disclosure targeted at litigation funders would not improve attorney ethics but rather would merely benefit the funded parties' adversaries."); *see also Fleet Connect Sols. LLC v. Waste Connections US,*

- CJL and ILR's speculative fear applies equally to any number of litigation funding arrangements. Attorneys who handle cases on a contingency fee basis provide litigation funding to their clients, but Texas law does not presume that the mere fact that they may exercise control and influence over the litigation means that they must disclose their fee agreements to opposing counsel in personal injury disputes.[18] Indeed, employers who pay for the defense of their employees may exercise control and influence over any lawsuits against their employees; parent entities who pay for the defense of their subsidiaries may, through their in-house counsel, exercise control and influence over any lawsuits against those subsidiaries.[19] Yet, CJL and ILR are not clamoring for disclosure of *those* kinds of litigation funding arrangements.

- CJL and ILR's speculative fear presumes that all commercial third-party litigation funding companies are dishonest. The law, however, generally does not presume dishonesty. There must be evidence of dishonesty to prompt an investigation.[20] "Just as it would not be appropriate to audit all taxpayers but rather only those whose filings raise a reasonable suspicion of illegality, we should not presumptively investigate litigation financing in all cases but rather only in the rare case where circumstances suggest to a neutral judge a specific area of ethical concern."[21]

Inc., No. 2:21-CV-00365-JRG, 2022 WL 2805132, *3 (E.D. Tex. June 29, 2022) (noting that a defendant's request for litigation funding agreements, in the absence of any evidence that the agreements were relevant, were "a fishing expedition that serves only to shift the burden of establishing proof of standing to Plaintiff prior to any good-faith challenge to standing being put forward by Defendant").

[18] *See* Marra, *supra* note 1, at 95 ("[T]he argument that litigation finance may create conflicts of interest between claimholder, funder, and lawyer applies with at least as much force to contingency fee arrangements."); *see also* W. Bradley Wendel, *Paying the Piper But Not Calling the Tune: Litigation Financing and Professional Independence*, 52 AKRON L. REV. 1, 47 (2019) ("[L]itigation financing is no different in this respect than the risks presented by hourly and contingency fees, both of which create their own characteristic misalignment of interests.").

[19] *See* Marra, *supra* note 1, at 95 (noting that if *any* third party holds the purse strings, *even when funding a defendant*, "a lawyer must be careful to resist the temptation to follow the third-party funder's wishes over those of her client").

[20] *Id.* at 102 ("[I]dle suspicion of wrongdoing has never been found to warrant discovery — much less mandatory disclosure."); *see In re Valsartan N-Nitrosodimethylamine Contamination Prods. Liab. Litig.*, 405 F. Supp. 3d 612, 615 (D.N.J. 2019) (stating that "rather than directing *carte blanche* discovery," disclosure of litigation funding would be relevant only on "a showing that something untoward occurred").

[21] Sharfman, *supra* note 11; *see* Marra, *supra* note 1, at 96 ("Our legal system takes these threats to a lawyer's independence seriously — but it does not deal with these threats by requiring mandatory disclosure whenever a third party is paying the attorney's legal fees, or by requiring lawyers to disclose whenever they are working on a contingent fee. Instead, we trust lawyers to satisfy their ethical duties to maintain their independence and place the interests of their clients first, without allowing opposing counsel to peer over their shoulder to monitor compliance."); Wendel, *supra* note 18, at 46-47 ("To the extent disinterested funding does present risks, they can be mitigated by existing rules of procedure . . . .").

Second, CJL and ILR say that there are "questions" about "potential manipulation" of the judicial process "by foreign actors." They cite "limited data" suggesting that "foreign actors" have previously funded intellectual property litigation in the United States, purportedly for the purpose of enabling those foreign actors to gain access to "sensitive technology." Intellectual property litigation, however, occurs almost exclusively in federal court and raises issues that are not usually relevant in state court.[22] CJL and ILR do not explain why "foreign actors" would have any interest in the kinds of personal injury lawsuits, or even commercial lawsuits, that are the subject of most litigation funding agreements for plaintiffs in the *Texas state courts* to which their proposed revisions to Rule 194 would apply. CJL and ILR certainly cite no evidence that "foreign actors" are seeking to influence any litigation *in Texas*.

And once again, CJL and ILR's speculative fear that "foreign actors" may exercise control or influence over lawsuits is no basis for a blanket rule of disclosure that applies only against plaintiffs. Significantly, CJL and ILR's letter to this Committee acknowledges on its face that foreign governments may seek as much or more to benefit *defendants* — for example, by providing funding to foreign entities defending against trade secret claims by American companies. Yet, CJL and ILR's proposed revisions to Rule 194 would not require that any *defendants* disclose any litigation funding from foreign actors; instead, their proposed revisions would only require the disclosure of litigation funding agreements in which the funding company receives a contingent interest in the outcome — *i.e.*, an interest in a *plaintiff's* potential recovery.

Absent any *specific* evidence that a litigation financing company or a "foreign actor" is acting improperly in a *specific* case, then the general rule — as it always has been in Texas — is that a party is entitled to discover only information that is relevant or reasonably calculated to lead to the discovery of admissible evidence.[23] The mere fact that a plaintiff has received litigation funding is not usually either relevant to a plaintiff's substantive claims or reasonably calculated to lead to any admissible evidence about those claims — just as the plaintiff's wealth, the plaintiff's financial condition, and the plaintiff's tax returns are not generally discoverable in civil litigation.[24]

Texas certainly never has approved a "shoot first" approach to discovery in which a party seeks information merely on the *hope* that the information might turn out to be relevant. To the contrary, Texas has long recognized that a party may not use the discovery process for the purpose of conducting a fishing expedition.[25] Any fishing expedition — *i.e.*, any search for documents

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[22] *Cf. Valsartan*, 405 F. Supp. 3d at 615 (noting that the cases in which federal courts have required disclosure of litigation funding agreements commonly have been intellectual property disputes "where the ownership of a patent is relevant to determining who has standing to bring the lawsuit").

[23] TEX. R. CIV. P. 192.3(a).

[24] *E.g.*, *Benitez v. Lopez*, No. 17-cv-3827, 2019 WL 1578167, *1 (E.D.N.Y. March 14, 2019); *see Miller UK Ltd. v. Caterpillar, Inc.*, 17 F. Supp. 3d 711, 721 (N.D. Ill. 2014) (noting that discovery is not "an excursion ticket to an unlimited exploration of every conceivable matter that captures an attorney's interest").

[25] *See In re American Optical Corp.*, 988 S.W.2d 711, 713 (Tex. 1998) ("This Court has repeatedly emphasized that discovery may not be used as a fishing expedition."); *see also Texaco, Inc. v. Sanderson*,

merely in the *hope* that it may generate relevant evidence — is improper as a matter of law because it spawns "unnecessary case-within-a-case litigation" that "is not a proper discovery objective."[26]

CJL and ILR's speculative fears are exactly what they appear to be — pretextual "the sky is falling" arguments that seek to mask their true intent. Their proposed revisions to Rule 194 have nothing to do with fears about "foreign actors." They instead have everything to do with trying to tip the scales of justice in favor of wealthy corporate defendants.

Litigation funding agreements are not analogous to insurance policies.

CJL and ILR's letter to the Committee emphasizes that Texas has previously amended Rule 194 to require the disclosure of insurance and indemnity agreements. They imply that litigation funding agreements are analogous to insurance policies, arguing that the mandatory disclosure of litigation funding agreements "would complement the existing insurance disclosure requirement and enable courts and defendants to more accurately evaluate settlement prospects and to better calibrate settlement initiatives."

As an initial matter, defendants have no vested right to peek behind the veil of any litigation financing arrangements to improve their own settlement prospects. "Never before has the law adopted procedural rules with an intention to strengthen the hand of one party so that it can settle more favorably with the other. Procedural rules are supposed to enhance the legal system's ability to adjudicate disputes on the merits, not to tilt outcomes in one direction or another."[27]

Regardless, third-party commercial litigation funding agreements are *not* analogous to insurance policies.[28] Insurance and indemnity agreements are subject to disclosure for a sound policy reason: they necessarily identify whether any third party "may be liable to satisfy part or all of a judgment rendered in the action or to indemnify or reimburse for payments made to satisfy the judgment."[29] Under litigation funding agreements, a third-party commercial litigation funding

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898 S.W.2d 813, 815 (Tex. 1995) (criticizing a broad request for all of the defendant's safety documents, without any evidence that they would bear "any relation to the case at all," is "not just an impermissible fishing expedition; it is an effort to dredge the lake in search of a fish").

[26] *In re National Lloyds Ins. Co.*, 532 S.W.3d 794, 799 (Tex. 2017).

[27] Sharfman, *supra* note 11.

[28] *See* Marra, *supra* note 1, at 103 ("The fact that insurance obligations must be disclosed speaks to the unique nature of defense-side insurance; it does not provide an argument for disclosure of other forms of third-party financing, including but not limited to commercial litigation finance."); *see also* Michelle Boardman, *Insurers Defend and Third Parties Fund: A Comparison of Litigation Participation*, 8 J.L. ECON. & POL. 673, 673 (2012) ("A comparison between these relationships is strained; the occasional similarity is overwhelmed by the differences.").

[29] TEX. R. CIV. P. 192.3(f); *see* Boardman, *supra* note 28, at 677 ("[T]he insurer's funds are on the hook for the eventual settlement or award.").

company is just that — a source of litigation funding, not a party potentially liable or responsible for all or part of a judgment or claim.[30]

That distinction is particularly relevant in Texas state court. Under Texas law, a plaintiff may make a *Stowers* demand for settlement within the limits of a defendant's insurance policy.[31] To be able to make such a demand, a plaintiff must first be aware of the defendant's policy limits. That, in fact, is part of the very reason Texas requires that the parties to a lawsuit disclose any insurance or indemnity agreements. No similar *Stowers* issue applies to a third-party commercial litigation funding agreement.

Litigation funding agreements are attorney work product.

CJL and ILR's letter to the Committee asserts that "there is little support for the notion" that the work product doctrine should shield litigation funding agreements from disclosure. To the contrary, case law from across the United States provides ample support for that notion. As just a few cases explain:

- The work product doctrine "exists to preserve and promote the adversarial system of litigation and prevent a party from free-riding on his opponent's efforts. In those instances where a claim cannot proceed without third-party financing, one element of preparing a client's case for trial will be securing the requisite funding, which probably will require discussions of a case's merits in an effort to convince the third party to supply the needed funds."[32] The work production protection extends to the litigation funding agreement itself, which "could reflect an analysis of the merits of the case."[33]

- A litigation funding agreement is "work product as it was entered into with the intent to facilitate litigation."[34] Work product protection is particularly important because

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[30] *Miller UK Ltd.,* 17 F. Supp. 3d at 729; *see* Marra, *supra* note 1, at 103 (noting that third-party commercial litigation funding "does not exist to satisfy the claim — instead, it simply provides financing to the claimholder, usually to meet the legal fees and costs necessary to advance the claim").

[31] *See Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d 765, 776 (Tex. 2007); *G.A. Stowers Furniture Co. v. American Indemnity Co.*, 15 S.W.2d 544, 547-48 (Tex. Comm'n App. 1929, holding approved).

[32] *Carlyle Inv. Mgmt. L.L.C. v. Moonmouth Co.*, No. 7841-VCP, 2015 WL 778846, *9 (Del. Ch. Feb. 24, 2015).

[33] *Id.*; *cf. National Lloyds*, 532 S.W.3d at 805 (noting that in Texas, the work product doctrine protects documents that, even incidentally, could "reveal the attorney's thought processes concerning the prosecution or defense of the case" or "provide a roadmap" of how she intends to handle the litigation).

[34] *In re Int'l Oil Trading Co.*, 548 B.R. 825, 838 (Bankr. S.D. Fla. 2016).

some of the terms of a litigation funding agreement may "represent an assessment of risk based on discussions of core opinion work product of the case."[35]

- Litigation funding agreements "are created 'because of' the litigation they fund."[36] Any business purpose of litigation funding agreements cannot be segregated from and indeed are "'profoundly interconnected' with the purpose of funding the litigation."[37]

And to the extent that CJL and ILR may — now or in the future — also want to seek the disclosure of any communications that plaintiffs may exchange with litigation funding companies about a lawsuit, those communications are protected work product as well.[38]

CJL and ILR suggest that if a litigation funding agreement contains any analysis of the merits or any assessment of risk, the plaintiff may simply redact the agreement before disclosing it. That, however, misses the point. The purpose of the disclosure requirement in Rule 194 is to ensure that the parties exchange "basic discovery" that would be relevant in just about every lawsuit and that would not normally require any redactions or claims of privilege.[39] CJL and ILR seek to do what Texas has never previously done — require the blanket disclosure of agreements that likely have no relevance at all to any issue in dispute and are potentially subject to significant work product concerns.

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[35] *Id.* at 839. Curiously, CJL and ILR's letter to the Committee itself cites the opinion *In re IOT* and suggests that the opinion actually supports the disclosure of litigation funding agreements. Although the bankruptcy court in *In re IOT* unquestionably found that the litigation funding agreement at issue in that case was work product, it concluded that the creditor had a substantial need for a copy of the agreement, which was relevant to a specific bankruptcy issue: whether the debtor had transferred or conveyed an asset of its estate — specifically, one or more of its causes of action — to a third party. *Id*. Even so, the bankruptcy court agreed that the debtor could redact "the terms of payment and any terms he reasonably believes may disclose attorney mental impressions and opinion." *Id.*

[36] *Continental Circuits LLC v. Intel Corp.*, 435 F. Supp. 3d 1014, 1020 (D. Ariz. 2020).

[37] *Id.* at 1021.

[38] *See, e.g., Design with Friends, Inc. v. Target Corp.*, No. 1:21-cv-01376-SB, 2024 WL 4333114, *3 (D. Dela. Sept. 27, 2024) ("These internal discussions leave a revealing trail of mental impressions, legal theories, and strategic notes — all created as confidential internal documents or sent under nondisclosure agreements, and so written with vulnerable candor. … If the work-product doctrine did not protect these records, then plaintiffs who got litigation finance would need to expose these confidential attorney impressions to their opponents. That would chill lawyers from discussing a pending case frankly. The work-product doctrine was created to prevent that result."); *see also U.S. v. Homeward Residential, Inc.,* No. 4:12-CV-461, 2016 WL 1031154, *6 (E.D. Tex. March 15, 2016); *Miller UK Ltd.,* 17 F. Supp. 3d at 738; *Devon IT, Inc. v. IBM Corp.,* No. 10-2899, 2012 WL 4748160, *1 n.1 (E.D. Pa. Sept. 27, 2012); *Mondis Tech., Ltd. v. LG Elecs., Inc.*, No. 2:07-CV-565-TJW-CE, 2011 WL 1714304, *3 (E.D. Tex. May 4, 2011).

[39] *See* TEX. R. CIV. P. 194 cmt. 1.

If a litigation funding agreement is truly relevant to a disputed issue in a lawsuit, then a defendant already has a remedy: it may seek to secure the agreement through a narrowly-tailored and properly-worded request for production under Rule 196 of the Texas Rules of Civil Procedure.[40] The plaintiff then has a reasonable opportunity to preserve any work production objections or claims of privilege. The trial court may review the agreement *in camera*. And as appropriate, the trial court may order the plaintiff to produce the agreement in its entirety or with redactions. Or, for that matter, the plaintiff may voluntarily produce the agreement in its entirety or with redactions. *That is how it should work*.

Texas law does not require the disclosure of contingency fee agreements under Rule 194; if contingency fee agreements are relevant to any disputed issue in a lawsuit, a defendant may request them through a proper request for production under Rule 196. The same should be no less true of litigation funding agreements.

Requiring blanket disclosure of commercial litigation funding agreements is unjust.

Ultimately, any blanket rule requiring that plaintiffs disclose any commercial third-party litigation funding agreements is a bad idea. Even if plaintiffs could redact the agreements to remove any analysis of the merits or any assessment of risk, the agreements themselves would still give defendants case-specific information that they could use to their strategic advantage.[41] As William Marra has explained:

> Mandatory disclosure tells a defendant at least two critical pieces about the plaintiff's case. First, it discloses *whether* the plaintiff has funding — revealing both the strength of those plaintiffs who have funding, and the weakness of those who do not. Second, it discloses *how much* funding the plaintiff has — giving defendants great leverage once they know that plaintiffs are running out of funds. For example, if the defendant knows that the plaintiff has $2,000,000 in funding, the defendant has a lot of leverage to reject a settlement offer proffered right about the time the defendant estimates the plaintiff has burned through that litigation budget.[42]

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[40] *See National Lloyds*, 532 S.W.3d at 806 (noting that the rules allow parties to submit a "narrowly tailored request for information relevant to an issue in a pending case that does not invade the attorney's strategic decisions or thought processes").

[41] *Cf. id.* (noting that redactions are insufficient if they cannot entirely mask an attorney's thought processes and strategies as to "when, how, and what resources" are or will be employed in a lawsuit).

[42] Marra, *supra* note 1, at 103-04 (emphasis in original); *see* Sharfman*, supra* note 11 ("Generally speaking, the last thing a party wants an adversary to know is that it cannot afford to prosecute or defend its case or that its case is not strong enough to attract much if any external funding. Adversaries who know this information can try to use it to win not on the merits, as the legal system intends, but instead through a battle of attrition."); *cf. Art Akiane LLC v. Art & Soulworks LLC*, No. 19 C 2952, 2020 WL 5593242, *6 (N.D. Ill. Sept. 18, 2020) (noting that knowledge of the existence, or not, of a litigation funding agreement "would allow the inquiring party to learn whether its opponent has financial difficulties requiring an outside infusion of capital, necessary to allow a party to sue in the first place or to defend itself in litigation").

A plaintiff has no similar strategic advantage against defendants. Texas does not require that defendants automatically disclose any of their sources of funding. Under Texas law, a plaintiff does not generally have the right to discover any agreements under which, for instance, an employer may provide litigation funding to an employee or a parent entity may provide litigation funding to a subsidiary.

CJL and ILR's proposed revisions to Rule 194 are unfounded, unprincipled, unjust, and unnecessary. The Committee should reject them.

JHK

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17-CV-BBBBBB

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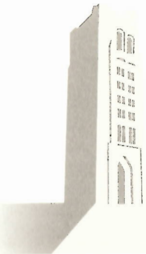
September 27, 2017

Ms. Rebecca A. Womeldorf
Secretary of the Committee on Rules of Practice and Procedure
Administrative Office of the United States Courts
One Columbus Circle, N.E.
Washington, D.C. 20544

Dear Ms. Womeldorf:

A June 1, 2017, letter from the U.S. Chamber Institute for Legal Reform and numerous allied organizations (collectively, "the Chamber") proposes an amendment to Rule 26(a)(1)(A) of the Federal Rules of Civil Procedure to require disclosure of third-party litigation funding in every civil case. Among other reasons the Chamber gives for mandatory disclosure is that it is necessary to enable district courts to carry out a function of "safeguarding legitimate, ethical civil litigation practices" by lawyers appearing before them. Chamber Letter, p. 10. Simply put, the Chamber seeks to enlist federal judges as monitors and enforcers of lawyer professional responsibility, a role that has traditionally been entrusted to state courts of last resort and agencies under their supervision.

Briefly on our qualifications: We both teach professional responsibility, at Cardozo (Sebok) and Cornell (Wendel) Law Schools, and we both have written extensively in this field. Wendel is a co-editor of a leading law school casebook, Geoffrey C. Hazard, et al., *The Law and Ethics of Lawyering*, now in its 6th edition, and is the sole author of a widely adopted student textbook, *Professional Responsibility: Examples and Explanations*, now in its 5th edition. He has been a member of the drafting committee for the Multistate Professional Responsibility Examination (MPRE) since 2007. Sebok is also a frequently cited scholar on third-party litigation funding, including its effect on the attorney-client relationship. He has taught and lectured about litigation finance internationally. He is a member of the American Law Institute, for which he serves as an Advisor for the forthcoming Restatement of Torts (Third), Intentional Torts to Persons, and is the Co-Director of the Jacob Burns Center on Ethics in the Practice of Law at Cardozo Law School.



We also served as co-Reporters to the American Bar Association's Ethics 20/20 Commission Working Group on Alternative Litigation Financing, and were co-drafters of the Commission's White Paper on this subject. The Ethics 20/20 Commission invited the submission of written comments and live testimony from interested parties regarding, among other things, the impact of third-party litigation funding on the compliance by lawyers with their ethical obligations. After considering public comments and extensive internal discussion, the Commission decided that the existing framework of state-based rules of professional conduct was sufficient to prevent any risks to the lawyer-client relationship created by third-party funding. The Commission therefore directed us to prepare a guidance document explaining any ethical issues implicated by third-party funding and their treatment by the disciplinary rules. After approval by the ABA House of Delegates, the White Paper was released and is available at https://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111212_ethics_20_20_alf_white_paper_final_hod_informational_report.authcheckdam.pdf

We write as scholars of legal ethics and professional responsibility, with a particular interest in third-party litigation funding. We both serve as outside ethics counsel to commercial litigation funding companies – Sebok for Burford Capital LLC, and Wendel for Bentham IMF and Longford Capital Management, LP. However, we submit this comment solely in our individual capacities. We have not reviewed this comment with any industry actor, nor have we been compensated for preparing this submission. But we do rely on many years of experience with leading players in the commercial litigation funding industry to support our contention that third-party litigation funding does not create risks for the lawyer-client relationship that cannot be mitigated by the conscientious application of existing state disciplinary rules.

I. Role of State Courts in Attorney Regulation

Lawyers often speak loosely about being admitted to "the bar," but strictly speaking that is incorrect. Lawyers are admitted to practice in a state by a state court – generally the court of last resort, although in New York it is the Appellate Divisions of the Supreme Court. State appellate courts have the inherent authority, as a matter of state constitutional law, to admit lawyers to practice in a state, to formulate and administer rules of professional responsibility, and to establish a system of lawyer discipline. *See* Restatement (Third) of the Law Governing Lawyers § 1, cmt. c (2000) (hereinafter "Restatement"); Charles W. Wolfram, *Modern Legal Ethics* §2.2.2 (1986) (hereinafter "Wolfram"). Lawyers may be required to join a state bar association when they are admitted to practice (a so-called "unified" or "integrated" bar), or may elect join one of several voluntary bar associations, but it is the state judiciary, not the organized bar, that adopts, investigates, and enforces remedies for lawyer misconduct. Wolfram § 2.3. Most states have adopted disciplinary rules based on the American Bar Association's Model Rules of Professional Conduct, but the authority to regulate is inherent in the state judiciary; the ABA has no regulatory authority. Lawyers who violate rules of professional conduct adopted by a state court may be subject to discipline ranging from a reprimand to permanent disbarment. *See* Restatement § 5.

Trial-level courts of general jurisdiction, both state and federal, have a different type of inherent power than the highest state appellate courts. This species of inherent power is related to the common-law authority to punish contempts, but also includes the right to insist upon silence and decorum in the courtroom, to vacate judgments procured by fraud, and to dismiss for *forum non conveniens*. *See, e.g.*, *Chambers v. NASCO, Inc.*, 501 U.S. 32, 43-44 (1991). Courts have relied upon this type of inherent authority to craft remedies for lawyer misconduct that directly affects the conduct of the proceedings.[1] Much of the law governing conflicts of interest is grounded in this form of inherent authority. Early, influential decisions applied the remedy of disqualifying counsel for one of the parties owing to its concurrent or prior representation of another party. *See, e.g.*, *T.C. Theatre Corp. v. Warner Bros. Pictures*, 113 F. Supp. 265 (S.D.N.Y. 1953); *Emle Indus., Inc. v. Patentex*, 478 F.2d 562 (2d Cir. 1973); *Cinema 5, Ltd. v. Cinerama, Inc.*, 528 F.2d 1384 (2d Cir. 1976); *IBM Corp. v. Levin*, 579 F.2d 271 (3d Cir. 1978). It is now recognized that the remedies crafted by these courts was dependent upon the inherent power of judges to regulate the conduct of lawyers appearing before them, as well as the courts' authority to issue injunctions and similar orders. *See* Restatement § 6, cmt. i.

It is extremely important to recognize the distinction between regulation attorney misconduct *in general* by the state appellate courts of and the exercise of inherent authority to regulate the conduct of lawyers having an impact on a pending proceeding. One difference is that for example, that a court can refer to legal principles other than those contained in the rules of professional conduct of a lawyer's state of admission.[2] Another

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[1] For example, a court may exclude evidence developed through an investigation outside the scope of the discovery process that involves communication with a party represented by counsel, *see, e.g.*, *Niesig v. Team I*, 558 N.E.2d 1030 (N.Y. 1990), or makes use of deceptive tactics, *see, e.g.*, *Midwest Motor Sports v. Arctic Cat Sales, Inc.*, 347 F.3d 693 (8th Cir. 2003); *In re Air Crash Disaster Near Roselawn, Indiana*, 909 F. Supp. 1116 (N.D. Ill. 1995).

[2]

> The district court has primary responsibility for controlling the conduct of attorneys practicing before it. Although the ABA does not establish rules of law that are binding on this Court, it is the Court's prerogative to disqualify counsel based on contravention of the ABA Model Rules. . . . This is true, despite the fact that neither this Court's Local

difference is the remedy involved. The state appellate courts can impose a range of sanctions relating to the practice of law such as suspensions and even disbarment, while attorney misconduct in the courtroom may result in a range of injunctive and monetary remedies. Trial courts are essentially on their own (subject to appellate precedent to the contrary) in crafting rules of conduct with respect to pending proceedings.

More to the point of our objection to the Chamber's proposal, the court's exercise of inherent authority over the conduct of the pending litigation is *not* for the purpose of protecting clients or the public generally, or ensuring high standards of ethical conduct by lawyers. That responsibility is vested in state appellate courts. As the New York Court of Appeals explained, in an opinion that remains influential today, state disciplinary rules have "a different provenance and purpose" than procedural rules governing the conduct of the parties and their counsel. *Niesig v. Team I*, 558 N.E.2d 1030, 1032 (N.Y. 1990). Disciplinary rules "embody[] principles of ethical conduct for attorneys as well as rules for professional discipline." *Id.* As such, they may strike a different balance among the policy considerations underlying the rule. *Id.* at 1033. The kind of inherent power involved in cases like *Niesig* is exercised for the purpose of protecting the integrity of the adversarial system and the litigation process, insofar as it affects the rights of the parties to a pending proceeding. Trial courts, including federal district courts, do not have a roving commission to regulate the ethics of the legal profession. That function is reserved to the highest courts of the admitting jurisdictions of lawyers, who adopt and enforce rules of professional conduct.

The Chamber asserts that third party funding "threaten core ethical" principles that "undergird our civil justice system" and that this threat justifies the disclosure rule they propose. This claim, to the extent that the word "ethical" refers to the rules attorney regulation described above, is based on two assumptions. First, that third party funding *in general* is more likely to lead attorneys to violate their professional responsibilities as set out in their states. And second, that to the extent that third party funding leads attorneys to violate their professional responsibilities as set out in their states (a claim we deny) the federal rules of procedure for a trial court should be used to address this threat to professional responsibility. We believe that the Chamber has failed to prove either assumption.

Rules nor the Rules of Professional Conduct of the State Bar of California expressly refers to the ABA Model Rules.

Securities Investors Protection Corp. v. Vigman, 587 F. Supp. 1358, 1362 (C.D. Cal. 1984) (with lengthy procedural history not relating to disqualification order).

II. Third Party Funding and the Risk of Violations of Professional Obligations by Attorneys

Violation of professional obligations by attorneys occur despite the fact that most attorneys strive to uphold the obligations imposed on them by the jurisdiction where they have been admitted to practice. The fact that violations of professional obligations *may* occur in the course of a transaction is not, in itself, a reason for the federal courts to address that kind of transaction. The ground for asking the federal courts to address the risk of ethical impropriety in third party funding is that there is some clear relationship between ethical impropriety and third party funding. The Chamber alleges such a connection, but we remain unconvinced based on the evidence it has presented. The Chamber's allegation is based on the putative appearance of ethical impropriety in three areas of professional responsibility.

A. Control Over the Conduct of Litigation

Critics of third-party litigation funding, including the Chamber in its submission, often invoke the image of the funder as a puppet master, secretly controlling the actions of the plaintiff and its counsel. An Australian High Court case generally known as *Fostif* approved a funding agreement that provides for extensive control by the funder over the conduct of the litigation, including retaining and discharging counsel, tactical decision-making, and acceptance or rejection of settlement offers. *See Campbells Cash and Carry Pty Limited v Fostif Pty Ltd* [2006] HCA 41. The Chamber seems to be suggesting that third party funding contracts seek to smuggle foreign concepts of third-party control into the attorney-client relationship in American cases.

Every attorney licensed in an American jurisdiction is obliged to obey certain rules designed to insure that the attorney's loyalty remains with her client. These rules include variations of Model Rule 1.2 (client determines objectives and scope of representation) and Model Rule 5.4 (guaranteeing the professional independence of the attorney). At their core, these obligations are not waivable by the client. Furthermore, the law of third party funding in the states does not permit clients to contract with funders to waive these obligations.

Certainly, as the Chamber knows, the mere fact that an attorney's client wishes to engage in third party funding in a jurisdiction where it is permitted under the local law does not increase the risk that the client's control over her attorney will be weakened. In New York, for example, the Bar Association of the City of New York noted that the rules of professional responsibility provide clear guidance to attorneys whose clients seek third party funding in the same way that these rules provide clear guidance to attorneys in other situations where third parties may seek to influence attorneys. *See* The Association of the Bar of the City of New York Committee on Professional Ethics, Formal Opinion 2011-2.

Furthermore, there are several well-established features of American law that prevent litigation funders from asserting control over critical decisions in litigation. These include:

- *Champerty concerns.* As discussed in the ABA Ethics 20/20 Commission's White Paper on alternative litigation finance, acquiring an interest in a litigant's cause of action is permitted, notwithstanding traditional restrictions on champerty, in many American states. However, even in states in which there is no longer a per se prohibition on champerty, a transaction may be deemed champertous and therefore voidable if the party acquiring the interest engages in "intermeddling" in the litigation, including seeking to control decision-making by the party and its lawyer. *See*, *e.g.*, *Am. Optical Co. v. Curtiss*, 56 F.R.D. 26, 29–32 (S.D.N.Y. 1971) (agreement limiting litigant's control over whether to sue violated Fed. R. Civ. P. 17(a) requirement of suit brought by real party in interest); *Kraft v. Mason*, 668 So. 2d 679, 682 (Fla. Dist. Ct. App. 1996) ("officious intermeddling" is an element of champerty). One Florida appellate court deemed a funder a "party" for the purposes of a fee-shifting statute because of the extent of control the funder exercised over the litigation. *See Abu-Ghazaleh v. Chaul*, 36 So. 3d 691, 693 (Fla. Dist. Ct. App. 2009) (disapproving of transaction where funder had right under financing agreement "to approve the filing of the lawsuit; controlled the selection of the plaintiffs' attorneys; recruited fact and expert witnesses; received, reviewed and approved counsel's bills; and had the ability to veto any settlement agreements.").

- *Control over settlement.* The exclusive right of the client to accept or reject settlement offers is another central principle in the law of lawyering. "The requirement that an attorney's advice to the client be 'independent' means that if the defendant in a civil case makes an offer to settle that is conditioned on a waiver of attorneys' fees, the lawyer must communicate the offer and render objective advice about its merits that is independent of the lawyer's own interests in protecting the fee." *ABA/BNA Lawyers' Manual on Prof'l Conduct* ¶ 41:1609 (citing numerous ethics opinions). The ethical obligation to preserve a client's control over settlement is maintained by parallel requirements in state law concerning third party funding. Courts will carefully scrutinize contractual provisions that have the effect of limiting or burdening the client's exclusive right to make decisions regarding settlement. Control over settlement, for example, is one difference that Florida invokes to distinguish between third party funding contracts that it will enforce as opposed to those it will not enforce. *Compare Brown v. Dyrnes*, 109 So. 2d 788 (Fla. Dist. Ct. App. 1959) (control sought and contract held to be void) *with Kraft v. Mason,* 668 So. 2d 679, 682 (Fla. Dist. Ct. App. 1996) (no control sought and contract found in accord with public policy). We accordingly advise our clients in the third-party funding industry that attempting to exercise any control over settlement would raise concerns for both the lawyers of the funded party and any court reviewing the enforceability of the contract.

These considerations are well understood, both by commercial litigation funders and by lawyers representing claimants in funded litigation. Both of us have reviewed numerous commercial litigation funding agreements, all of which specifically disclaim any attempt by the funder to exert any control over the conduct of the litigation by counsel. Mandatory disclosure of third-party financing is not warranted on this ground because there is nothing to discover. Reputable commercial financing firms are not calling the shots in litigation. They protect their investment by extensive due diligence and transactional structures that do not interfere with the lawyer-client relationship.

B. Sharing Fees with Non-Lawyers

Model Rule 5.4(a), a version of which is in effect in every jurisdiction except for the District of Columbia, prohibits sharing legal fees with non-lawyers. The prohibition on fee-splitting protects clients and society against three dangers.

- First, the prohibition of fee-splitting with non-lawyer employees and agents serves the goal of preventing the unauthorized practice of law (UPL). *See O'Hara v. Ahlgren, Blumenfeld & Kempster*, 127 Ill. 2d 333, 342 (1989) (fee-splitting arrangements facilitate UPL).

- Second, the prohibition of fee-splitting with non-lawyer employees and agents serves the goal of preventing the impermissible solicitation of clients. *See* Wolfram § 16.5. For typical solicitation cases involving "runners" or "cappers" *see, e.g., In re Nelson*, 1 Cal. State Bar Ct. Rptr. 178 (Review Dept. 1990); *Danzig v. Danzig*, 904 P.2d 312 (Wash. Ct. App. 1995). The underlying concern in the runner/solicitation cases is that there will be a bidding war among lawyers paying for client referrals. *See, e.g., Crawford v. State Bar*, 7 Cal. Rptr. 746, 355 P.2d 490 (1960); *see also McIntosh v. Mills*, 117 Cal. Rptr. 3d 66, 74 (Cal. Ct. App. 2004) (summarizing purposes of fees-splitting rule and citing numerous cases). The rule appears to be implicated most frequently today in the context of referral arrangements and the compensation of client-development consultants and in-house employees. *See, e.g., Son v. Margolius, Mallios, Davis, Rider & Tomar*, 709 A.2d 112 (Md. Ct. App. 1998);

In re Rappaport, 588 N.Y.S.2d 436 (App. Div. 1992); *Trotter v. Nelson*, 684 N.E.2d 1150 (Ind. 1997); *State Bar of Texas v. Faubion*, 821 S.W.2d 203 (Tex. 1991); *In re Anonymous Member of the South Carolina Bar*, 367 S.E.2d 17 (S.C. 1988); Penn. Bar Op. 2004-3 (2004); Fla. Bar Op. 02-1 (2002); N.C. Bar Op. 147 (1993); N.Y. State Bar Op. 927 (2012); N.Y. State Bar Op. 727 (2000).

- Third, the prohibition of fee-splitting with non-lawyer employees and agents serves the goal of preventing non-lawyer interference with an attorney's professional judgment. As Comment [1] to Rule 5.4 states, the limitations in the rule "are to protect the lawyer's professional independence of judgment." *See, e.g.* Lawrence J. Fox, *Accountants, the Hawks of the Professional World: They Foul Our Nest and Theirs Too, Plus Other Ruminations on the Issue of MDPs*, 84 Minn. L. Rev. 1097, 1106 (2000) (arguing that Rule 5.4 guards against "interference by non-law trained masters who wish us to take short cuts to maximize profits"). Ethics opinions barring fee splitting with non-lawyer agents emphasize that there is a risk that, when a lawyer's agent's earnings are contingent on the outcome of a case on which he works, he may act against the client's interests by directing (or otherwise causing) the attorney to invest time and other resources among multiple clients based on which case promises the greatest reward and not what would be required under the attorney's obligation to provide competent representation. *See* Tex. Disciplinary Rules of Prof'l Conduct R. 5.04 cmt. 1 *and* D.C. Bar Op. 322 (2004).

The Chamber's bare allegation that third party funding raises special concerns relating to fee-splitting do not connect third party funding with the concerns outlined above. Funders are capital providers, like banks, and transact directly with clients, not the clients' attorneys. They do not offer to work for attorneys and split a fee with them. Funders do not seek to earn referral fees and do not seek to "sell" client referrals to attorneys. And, as noted above, funders are prohibited under the state laws of champerty to seek to take control of a client's litigation decisions, so they are not in a position to interfere with an attorney's ability to communicate her independent legal judgment to her client.

The Chamber's letter fails to draw a connection between the main purpose of the prohibition on fee-splitting and third party funding because the Chamber fails to recognize that third party funding is a form of financing. The fee-splitting rule cannot be applied rigidly or formalistically to law firm financing transactions, because even something as ordinary and pervasive as interest payments on a commercial line of credit must, by definition, involve the sharing of legal fees with a non-lawyer.[3] Similarly, paying financing charges to a credit card issuer would involve the sharing of legal fees with a non-lawyer, yet these payments are universally permitted. *See, e.g.*, Cal. State Bar Formal Op. 2007-172 (permitting lawyers to accept payments of fees by credit card, even though the attorney makes a payment out of the earned fees by means of a service-charge debit, notwithstanding literal violation of California fee-splitting rule); Or. Bar Op. 2005-133 (2005) (establishing credit facility to pay lawyers' fee, in return for 10% financing charge, does not violate Rule 5.4(a)); Ill. Bar Op. 92-9 (1993) (same result as Oregon opinion, on a similarly structured transaction). Law firms may even, with appropriate safeguards, take out a loan to finance the expenses of litigation and pass the interest expense along to the client. *See, e.g., Chittenden v. State Farm Mut. Auto. Ins. Co.*, 788 So.2d 1140 (La. 2001); Mich. Op. RI-332 (2003); N.Y. State Bar Ass'n Op. 754 (2002); Kent. Bar Op. E-420 (2002); Ariz. Bar Op. 01-07 (2001); L.A. County Bar Op. 499 (1999); Ill. Bar Op. 94-06 (1994).

No one seriously contends that ordinary financing transactions such as these violate the fee-splitting rule. *See* Geoffrey C. Hazard, Jr. & W. William Hodes, *The Law of Lawyering* (3d. ed. supp. 2011) § 45.5, Illus. 45-1; Doug Richmond, *Other People's Money: The Ethics of Litigation Funding*, 56 Mercer L. Rev. 649, 677 (2005) ("Of course there is no prohibition against attorneys borrowing from banks to finance their practices. No courts or disciplinary authorities have ever suggested that attorneys who finance aspects of their practices with bank loans "share" or "split" their fees with the banks when they make loan payments."). Significantly, a recent ethics opinion of the New York City Bar approved of third-party litigation financing without mentioning New York's version of Model Rule 5.4, except in the context of referral fees and in support of the proposition that "absent client consent, a lawyer may not permit the company to influence his or her professional judgment in determining the course or strategy of the litigation, including the decisions of whether to settle or the amount to accept in any settlement." *See* Ass'n of the Bar of the City of N.Y. Op. 2011-2 (2011).

The Virginia State Bar's Standing Committee on Legal Ethics, when faced with a different issue concerning the application of Virginia's version of Model Rule 5.4(a) to an innovative financing agreement between a client and a lawyer, offered advice which we think other committees will heed. The opinion, Virginia Legal Ethics Op. 1783 (2003), considered a case in which an attorney was hired to collect on a promissory note that included a provision requiring payment of 25% of the principal balance as attorneys' fees in the event of a collection action. Because the lender had been paying the attorney on an hourly basis and the attorney proposed to reimburse the lender out of the proceeds of the

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[3] Because law firms are prohibited from forming partnerships with non-lawyers, *see* Model Rule 5.4(b), any revenue of a law firm must come from attorneys' fees.

recovery, including the 25% attorneys' fee, the attorney was concerned that reimbursing the lender would violate the fee-splitting rule. The committee held that, on its face, this transaction involved splitting an attorney's fee with a client who was also, in effect, a third-party payor. It emphasized, however, that "application of Rule 5.4(a) must move beyond a literal application of language of the provision to include also consideration of the foundational purpose for that provision." The purpose is to avoid improper interference by third parties with the conduct of the litigation. The Committee noted that it had repeatedly emphasized that "[t]he primary purpose of Rule 5.4 is to prohibit nonlawyer interference with a lawyer's professional judgment and ensure lawyer independence." *Id.* (citing Va. Legal Ethics Op. 1744 (no violation of the fee-splitting rule in sharing portion of court-awarded fees with nonprofit organization)).

The most closely analogous authority on the application of Model Rule 5.4(a) to the specific context of third-party litigation financing is a series of ethics opinions from the Utah State Bar Ethics Advisory Committee. The Utah opinions employ the substance-over-form approach that characterize the only sensible analysis of the application of the fee-splitting rule to financing transactions. The permissibility of the transactions turns on whether they are structured in a way that creates the potential for a severe misalignment of interests between the funded law firm and the client.

The most relevant of the three opinions, Utah Bar Ethics Opinion 06-03, involved a loan by a third-party litigation financing company to a law firm, with a conditional obligation on the part of the lawyer to repay out of the proceeds of any judgment or settlement received. Because the obligation made reference to a single case for which the lawyer had borrowed from the third-party lender, there were foreseeable situations in which the lawyer would be better off financially if he lost the case and the client recovered nothing. For example, if the lawyer had borrowed $80,000 to finance $100,000 of litigation costs and expenses, and obtained a recovery of $100,000 for the client, the lawyer's obligation would be to repay the original $80,000, plus a funding fee of $80,000, for a total of $160,000. If, on the other hand, the lawyer "took a dive" in the case and recovered nothing for the client, the lawyer would be obligated to pay the lender nothing. The adverse incentive created by the presence of third-party financing was deemed an intolerable limitation on the lawyer's independence. On those narrow grounds, the opinion concluded that the investment violated the fee-splitting rule. The opinion noted, however, that a non-recourse financing arrangement in which it was it is "mathematically impossible for the lawyer to be able to reduce the lawyer's losses by obtaining no recovery for the client" would not violate Utah's prohibition on fee-splitting.

These authorities show that the fee-splitting rule cannot be applied literally or formalistically to financing transactions. An analysis that considers the substance of the fee-splitting rule over its form focuses on the effect the financing transaction has on the lawyer's independence and professional judgment. The blanket disclosure requirement for which the Chamber is advocating is unsuited to this kind of highly fact-specific, rule-of-reason analysis. The putative concern about fee-splitting cited by the Chamber cannot be supported by reference to the small set of cases, like that described in Utah Opinion 06-03, in which a financing transaction creates an impermissible interference with a lawyer's independent professional judgment.

C. Conflicts of Interest

Lawyer independence is also regulated by conflict of interest rules promulgated by state appellate courts, and generally based on Model Rules 1.7, 1.8, and 1.9 (the major provisions governing conflicts of interest arising out of concurrent representation, personal interests of an attorney, and successive representation, respectively). The Chamber seems to be arguing that disclosure of financing transactions must be mandatory so that the district court can investigate the transaction to determine whether it creates impermissible conflicts of interest. As is the case with the fee-splitting rule, application of the conflicts rules is highly fact-specific, and would involve district judges in lengthy, often quite technical, and unnecessary investigations into the possibility of conflicts of interest. This burdensome requirement is particularly inappropriate when it is quite clear that the potentially adverse financial interests of a lawyer do not create conflicts of interest at all.

For example, ordinary contingent fee financing involves a well-known conflict between the attorney's interest in maximizing his or her effective hourly rate and the client's interest in obtaining a larger judgment or settlement. This structural problem has never been treated as creating a conflict under Model Rule 1.7, *see* Hazard & Hodes, *supra* § 8.14.1, nor has the situation in which lawyers have incurred substantial indebtedness to a commercial lender to finance the representation of a client in a particular matter. Similarly, the U.S. Supreme Court refused to use the term "ethical dilemma" to refer to a settlement offer conditioned upon an agreement by the plaintiff's lawyer to waive a statutory entitlement to seek attorney's fees. *See Evans v. Jeff D*, 475 U.S. 717 (1986). Justice Stevens wrote:

> [A] lawyer is under an ethical obligation to exercise independent professional judgment on behalf of his client; he must not allow his own interests, financial or otherwise, to influence his professional advice. Accordingly, it is argued that a lawyer is required to evaluate a settlement offer on the basis of his client's interest, without considering his own interest in obtaining a fee; upon recommending settlement, he must abide by the client's decision whether or not to accept the offer.

Lawyers are also under a professional obligation, and not regarded as subject to a conflict of interest or in an ethical dilemma under the rules, where they are paid by a liability insurer to defend the interests of an insured. Other provisions in the rules, such as the independence requirement of Model Rule 2.1 and the allocation of decision-making authority in Model Rule 1.2(a), ensure that the client's interests are protected. *See* Hazard & Hodes, *supra* § 45.3, at 45-6. It is a highly unusual situation in which the conflict between an attorney's financial interests and the obligation to provide independent advice to a client will be deemed so severe that it rises to the level of an ethical dilemma mandating separate treatment under the rules, as opposed to being merely one of the ways in which the obligation of professionalism can occasionally be demanding.

III. Amending Rule 26 To Address Alleged Violations of Professional Responsibility

As we have argued in the foregoing section, we do not believe that the Chamber has demonstrated that third party funding is associated with a special or salient risk of attorney misconduct. However, even if there were some concern with professional responsibility that arose from third party funding, we are skeptical that an amendment to the federal rules relating to disclosure of third party funding in litigation would effectively address the risk of attorney misconduct.

It bears repeating that the goals of the various states' rules of professional responsibility and the goals of rules of procedure (state or federal) are different. The rules of procedure are designed to promote justice by protecting the interests of the parties adverse to each other in litigation. The rules of professional responsibility are designed to protect the interests of clients to the extent that those interests can promoted through the legal system in ways that do not harm third parties, the courts, and society in general. Sometimes, of course, rules intended to serve ends in litigation overlap with the rules of professional responsibility. For example, the rules concerning the disqualification of counsel due to concurrent conflicts in federal courts borrow directly from the rules of concurrent conflict adopted by the various bar disciplinary bodies. *See, e.g. Richardson v. Hamilton Int'l Corp.*, 469 F.2d 1382, 1383-84 (3d Cir. 1972) (American Bar Association's Code of Professional Responsibility provided the content of Rule 11 of the Local Rules of the United States District Court for the Eastern District of Pennsylvania with regard to determining disqualification of a party plaintiff).

The Chamber is suggesting that the requirements of professional responsibility are so clear that it would be easy and costless for the federal rules to assist in their enforcement while pursuing others ends, such as balancing the interest of adverse parties in discovery.

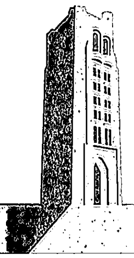
But it is unlikely that the rules of professional responsibility would be reinforced by the proposed disclosure rule in a way that was either simple or costless.

To take but one example, we demonstrate above that the so-called concern with fee-splitting – as it connects up with third party funding – is really a concern with the risks that certain forms of financing would impermissibly interfere with lawyers' independent professional judgment. The problem with trying to assist the various states in their regulations of this kind of financing (assuming that the states need assistance, which we deny) is that the states do not agree over the definition of the form of financing that would impermissibly interfere with lawyers' independent professional judgment. One ethics committee in Ohio, for example, has taken the extreme position that any form of factoring of a legal fee is fee-splitting, even if the lawyer is offering to sell to a factor a fee that arises from a settlement approved by a court. *See* Advisory Opinion, Ohio Supreme Court's Board of Commissioners on Grievances and Discipline, Opinion 2004-2 (transaction violates Rule 5.4(a)). On the other hand, Utah, as seen above, does not consider the sale of a contingent fee prior to settlement in exchange for financing to be even a question of fee-splitting, but treats the question as one of a waivable conflict of interest under Rule 1.7(a)(2). As this range illustrates, there is no single national perspective on the so-called "problem" of fee-splitting as it relates to third party funding secured by an attorney's immature contingent fee. There is a diversity of interpretations among the states and the authorities charged with enforcing the prohibition on fee-splitting. *See* Anthony J. Sebok, *Unmatured Attorneys' Fees and Capital Formation in Legal Markets*, 2018 Ill. L. Rev. ___ (forthcoming 2018). It hard to see how a federal rule can support all the various jurisdictions in their effort to ensure that attorneys are fulfilling their professional responsibilities if the rule will be necessarily either over- or under-inclusive in its characterization of the rule it is trying to reinforce.

It is instructive to see how courts have responded to invitations by parties to incorporate claims about violations of the prohibition on fee-splitting in cases where contingent fees have been financed and disputes have arisen over obligations to pay. In numerous cases where debtors have raised the argument that their obligations were based on contracts that violated public policy because they were based on violations of obligations of professional responsibility, the courts have eschewed any invitation to consider the effect of their decision on the promotion of the rules of professional responsibility and looked narrowly at the underlying contract. In *Santander Bank, N.A. v. Durham Comm. Capital Corp.*, Civil Action No. 14-13133-FDS, 2016 U.S. Dist. LEXIS 5430 (D. Mass. Jan. 15, 2016), for example, the court held that Massachusetts Rules of Professional Conduct were relevant its analysis of whether earned fees could be sold given the limitations of Rule 5.4(a), the court analyzed the argument only in terms of its relevance to Massachusetts contract interpretation, and not in terms of how its decision would address or affect the risk of attorney misconduct. The same analysis can be seen is other cases that refused to hold finance agreements void because they allegedly involved impermissible forms of fee-splitting. *See, e.g. Lawsuit Funding, LLC v. Lessoff*, 2013 WL 6409971 at *5 (NY Sup. Crt. 2013 *and PNC Bank v. Berg*, 1997 WL 529978, at *10 n.5 (Del. Super. Ct. 1997). The court in one Texas case was very blunt about the relevance of allegations that impermissible fee-splitting would be rewarded in its review of the enforceability of finance agreement: "any alleged violation of the Disciplinary Rules does not necessarily establish a cause of action 'nor does it void an otherwise valid contract executed outside of the attorney-client relationship.'" *Counsel Fin. Servs., L.L.C. v. Leibowitz*, 2013 Tex. App. LEXIS 9252, 2013 WL 3895331, at *24 (Tex. App. 2013), *reh'g overruled* (2013), *rev. den.* (2014)) (citation omitted).

Courts keep claims about violations of the rules concerning fee-splitting at arms-length for a reason, which is that they recognize that even in their own jurisdiction the enforcement of the obligations of attorneys in connection with financing litigation involves unsettled ethical principles which they are not equipped to evaluate. If it is this difficult for state courts to adopt and apply rules within their own jurisdiction, it seems to us to be highly unlikely that claims about the application of the rules of professional responsibility to financing by third party funders are likely to be accurate. The burden is on the Chamber to explain how its proposal promotes the enforcement of the states' rules of professional obligations. The letter submitted by the Chamber does not even attempt to meet this burden — it assumes that any amendment to the federal rules that is consistent with one state's rules of professional responsibility, even if only of marginal benefit in that one state, justifies an amendment to the rules of procedure. That assumption is unproved and therefore we conclude that the Chamber has failed to meet its burden. Furthermore, for reasons stated in this letter, we think it is highly unlikely that they could ever meet its burden.

In conclusion, we would like to emphasize that we are writing only in response to the Chamber's assertion that its proposed amendment to Rule 26(a)(1)(A) of the Federal Rules of Civil Procedure to require disclosure of third-party litigation should occur so that "core ethical principles" in the legal profession will be protected. This claim is supported by two assertions. The first is that third party funding is currently causing lawyers to act in violation of their states' ethical obligations. The second is that the proposed amendment to the federal rules of civil procedure can help with the threat to professional ethics putatively identified by the Chamber. Our response is simple. First, we do not see any evidence – in the Chamber's letter or in our own experience – that third party funding is causing lawyers to act in violation of their states' ethical obligations. Second, we do not think that amending Rule 26 of the Federal Rules of Civil Procedure will help the states promote ethical conduct among their lawyers in connection with the concerns raised by



the Chamber. In the absence of a need for intervention and in the face of no evidence that the intervention recommended will actually help, we urge the Committee to reject the proposed amendment.

Sincerely,

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Sincerely,

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17-CV-FFFFFF

November 1, 2017

Ms. Rebecca A. Womeldorf
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: Submission 17-CV-O

Dear Ms. Womeldorf:

I am writing regarding Submission 17-CV-O, the proposal multiple organizations have made to the Advisory Committee on Civil Rules ("Committee") suggesting that Fed. R. Civ. P. 26(a)(1)(A) be amended to require initial disclosures about third-party litigation funding ("TPLF"). My understanding is that this Submission is on the agenda for the Committee's November 7, 2017 meeting, and I urge the Committee to support this potential rule change, which I believe has substantial merit.

In House Judiciary Committee hearings and in other communications, we have heard in recent years increasing concerns about TPLF, which is clearly proliferating in civil litigation matters in our federal courts. Based on those concerns, I included in the Fairness in Class Action Litigation Act, H.R. 985, which passed the House in March, a provision requiring disclosure of TPLF in federal court class action cases. A fuller explanation of the need for requiring such a policy is set out at pages 27 through 29 of the committee report on the bill, which is available here: https://www.congress.gov/115/crpt/hrpt25/CRPT-115hrpt25.pdf. That requirement was limited to class actions, because such litigation was the focus of that bill. But in all cases, judges and parties need to know when and how TPLF is being used, so that appropriate steps can be taken to avoid conflicts of interest, to ensure compliance with ethical rules, and to protect the legitimate interests of all litigants. Indeed, it is hard to discern a valid argument against requiring such transparency. I therefore urge the Committee to give careful consideration to the rule change proposed in Submission 17-CV-O and ultimately support it.

Sincerely,

Bob Goodlatte

Chairman Bob Goodlatte

AMERICAN ASSOCIATION for JUSTICE

January 17, 2018

18-CV-B

Ms. Rebecca A. Womeldorf
Secretary of the Committee on Rules of Practice and Procedure
Administrative Office of the U.S. Courts
One Columbus Circle, NE
Washington, DC 20544

RE: Third-Party Litigation Funding

Dear Ms. Womeldorf:

The American Association for Justice ("AAJ"), formerly known as the Association of Trial Lawyers of America ("ATLA"), hereby submits these comments in response to the numerous requests for rule-making on third-party litigation financing ("TPLF") and, in particular, the request for mandatory disclosure of third-party litigation agreements presented in the U.S. Chamber's Institute for Legal Reform ("ILR")'s most recent submission. See 17-CV-O and 17-CV- GGGGGG. This proposal is the most recent in a long chain of one-sided proposals directed towards the plaintiffs' bar regarding TPLF. AAJ, with members in the United States, Canada and abroad, works to preserve the constitutional right to trial by jury and access to justice when people are injured by the negligence or misconduct of others. AAJ advocates to ensure that all plaintiffs, including employees, consumers, patients, families, shareholders and businesses injured by corporations, receive proper access to the courts under fair, just, and reasonable rules of procedure.

I. Background.

AAJ generally opposes proposals to limit TPLF funding and access to capital for members of the plaintiffs' bar. Many plaintiffs' attorneys avail themselves of third-party litigation funding over the course of their professional lives. While AAJ is unable to quantify numbers or percentages of AAJ members that use funding, AAJ can say that some attorneys use TPLF frequently while others use it occasionally or not at all. Additionally, TPLF takes many different forms and one-size does not fit all. Indeed, the Committee previously noted the lack of universal definition of TPLF and recognized the need to ensure a narrowly crafted definition in any potential rulemaking to prevent an overbroad rule. AAJ agrees that this is a legitimate concern with these proposals.[1]

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[1] Minutes of the Civil Rules Committee October 2014 Meeting, Agenda Book of the Advisory Committee on Civil Rules, page 49 (April 2015) ("It is not clear just what forms of financial assistance to a lawyer or to a party might be included under this label, nor is it clear whether the label itself should be adopted. Many ads offering financial

While AAJ recognizes that the rise of TPLF is seen as a "phenomenon" in the last several years, its arrival and growth is not surprising to AAJ. The reason that TPLF exists is because traditional access to financing and capital, particularly post-recession, often was not available to members of the plaintiffs' bar, whose business model was considered too uncertain by traditional banks to extend lines of credits or other types of commercial loans.[2] However, other types of financial institutions, particularly those with in-depth knowledge of how litigation works, did find an interest in providing plaintiffs' firms with adequate financing. Access to adequate financing when litigating against a corporate defendant that has comparatively far more resources became instrumental in the success of many plaintiffs' lawsuits.[3] As success of this type of financing grew, other types of institutions have taken interest in financing plaintiffs' lawyers, and the types (individuals, banks, hedge funds, etc.) and models of litigation financing (be it individual cases, firms or portfolios of cases) continue to evolve.[4]

ILR's most recent submission should be familiar to the Advisory Committee. In April 2014, ILR and similarly-interested groups submitted a remarkably similar proposal to require mandatory disclosure of TPLF under Rule 26. Given the novelty of TPLF and contentious debate surrounding the alleged concerns over TPLF, the Advisory Committee decided in October 2014 that rulemaking on the proposal was "premature."[5]

ILR's most recent submission on this subject reiterates the same alleged concerns contained in its 2014 comments, and ILR has requested that the Committee reopen its consideration due to "several relevant noteworthy developments."[6] These new developments mainly appear to be data on financial success of a few TPLF entities, the alleged "expansion" of TPLF funding models, and the recent standing order of one district court to require TPLF funding in class/mass actions.[7]

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support to lawyers seem to involve general loans to the firm, or to be ambiguous on the relationship between possible financing terms and specific individual litigation.").

[2] Maya Steinitz, *Whose Claim Is This Anyway? Third-Party Litigation Funding*, 95 MINN. L. REV. 1268, 1275-1285 (2010-2011), *available at* http://www.minnesotalawreview.org/wp-content/uploads/2012/03/Steinitz_PDF.pdf.

[3] *Id.* at 1305 ("One-shotters' (i.e., individual plaintiffs') bargaining positions will be most radically transformed by litigation funding as plaintiffs are transformed from one-shotters to modified repeat players. By allying themselves with repeat-player funders, these plaintiffs will now reap the benefits of economies of scale, accumulated expertise, and a limited ability to play for rules, in addition to gaining access to justice."); *see also* Jan Wolfe, *Got Your Back*, The American Lawyer, 13-14 (Feb. 2014), *available at* http://www.americanlawyer-digital.com/americanlawyer-ipauth/201402ip?pg=13#pg13.

[4] *See* Burford Capital, 2017 Litigation Finance Survey (2017), *available at* http://www.burfordcapital.com/wp-content/uploads/2017/09/Burford-2017-Litigation-Finance-Research-Whitepaper.pdf.

[5] Minutes of the Civil Rules Committee October 2014 Meeting, Agenda Book of the Advisory Committee on Civil Rules, page 54 (April 2015)("But third-party financing practices are in a formative stage. They are being examined by others. They have ethical overtones. We should not act now. . . There has been a flurry of articles. 'The authors are all over the place.' Some, highly respected, have suggested that the concerns reflected by this proposal are premature. The Committee decided not to act on these issues now.").

[6] U.S. Chamber Institute for Legal Reform, Renewed Proposal to Amend Fed. R. Civ. P. 26(a)(1)(A) 17-CV-O (June 1, 2017).

[7] *Id.*

AAJ would contest of the novelty of some of these "developments." Also, data on whether certain TPLF entities are lucrative or not hardly justify a new discovery rule, and the Committee reporters have similarly questioned the relevance of this information.[8] Furthermore, one district court's experimentation with disclosure – one much more limited than that suggested by ILR – does not justify rulemaking either. On the other hand, it incentivizes a wait-and-see approach as courts (and state ethics commissions) experiment with different approaches.

Nevertheless, none of these "developments" justify reconsideration of the Committee's reasonable decision that rulemaking on this matter is premature. Most importantly, ILR's substantive reasons to justify the rulemaking have not changed.[9] ILR argues that disclosure is necessary so that the court and parties can identify the real party of interest in the litigation and disclose conflicts of interest. While AAJ disagrees with ILR's assessment of TPLF and the role it plays in litigation, AAJ mainly questions the true motivations of this proposal. If identification of potential conflicts of interest is the overarching concern of a rulemaking, then why not suggest an amendment to Rules 17(a) or 7.1, as the Committee reporter has suggested on this issue?[10] These repetitive proposals' insistence on an amendment to the discovery rules perhaps shows their true motivation, which may be to make the litigation so expensive and so impossible to bring for plaintiffs – even when adequately financed by a third party – that ultimately a meritorious case will not be brought.[11] It must be alarming to corporate defendants to face more well-financed plaintiffs when lack of funding denied so many of these injured plaintiffs a day in court before the advent of TPLF.[12]

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[8] Rule 26(a)(1)(A) Reporters Memorandum and Suggestion 14-CV-B, Agenda Book of the Advisory Committee on Civil Rules, page 121 (October 2014) ("Perhaps relatedly, the submission seems to suggest that TPLF arrangements are somehow improper. Not only does it describe TPLF companies as 'lucrative," . . . How this factor should affect a determination about the parties' resources under amended Rule 26(b)(1) (if it is amended effective Dec. 1, 2015) is uncertain . . .'[C]onsideration of the parties' resources does not foreclose discovery requests addressed to an impecunious party, nor justify unlimited discovery requests addressed to a wealthy party. The 1983 Committee Note cautioned that '[t]he court must apply the standards in an even-handed manner that will prevent use of discovery to wage a war of attrition or as a device to coerce a party whether financially weak or affluent'" (citing Committee Note).).

[9] *Compare* U.S. Chamber Institute for Legal Reform, Proposed Amendment to Fed. R. Civ. P. 26(a)(1)(A) 14-CV-B (April 9, 2014) *with* U.S. Chamber Institute for Legal Reform, Renewed Proposal to Amend Fed. R. Civ. P. 26(a)(1)(A) 17-CV-O (June 1, 2017).

[10] Rule 26(a)(1)(A) Reporters Memorandum and Suggestion 14-CV-B, Agenda Book of the Advisory Committee on Civil Rules, page 120 (October 2014) ("Finally, it might be noted that if the objective is to identify those with a real stake in the litigation, some revision of Rule 17(a) on real party in interest might be in order."); id. at page 118 ("Whether that would make information about this subject discoverable under Rule 26 is uncertain. It might be that the right focus would be on Rule 7.1 disclosure statements.').

[11] *See, e.g.*, Binyamin Appelbaum, *Investors Put Money on Lawsuits to Get Payouts*, N.Y. TIMES (Nov. 14, 2010), *available at* http://www.nytimes.com/2010/11/15/business/15lawsuit.html?pagewanted=all ("The rise of lending to plaintiffs and their lawyers is a result of the high cost of litigation. Pursuing a civil action in federal court costs an average of$15,000, the Federal Judicial Center reported last year. Cases involving scientific evidence, like medical malpractice claims, often cost more than $100,000. Some people cannot afford to pursue claims; others are overwhelmed by corporate defendants with deeper pockets. A review by The New York Times and the Center for Public Integrity shows that the inflow of money is giving more people a day in court and arming them with well-paid experts and elaborate evidence. It is helping to ensure that cases are decided by merit rather than resources, echoing and expanding a shift a century ago when lawyers started fronting money for clients' lawsuits.").

[12] *Id.*

II. ILR's One-Sided Proposal.

ILR's proposal can be found on page 33 of their 17-CV-O submission.[13]

The proposed amendment would add the following to Rule 26(a)(1)(A):

> "(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."[14]

As in the versions before, the disclosure requirement as drafted by the ILR is completely one-sided. It only applies to the plaintiffs' bar, even though the biggest funding companies provide funding for both plaintiffs and defendants. The disclosure requirement applies to all types of funding, including traditional sources of funding as well as third-party litigation funding. No definition of "agreement" is provided in the proposal. Finally, the draft requiring disclosure under Rule 34 does not solve the problems raised by ILR, mainly that TPLF may raise potential conflicts of interest. While AAJ disagrees with ILR's purported reasons for rulemaking, if indeed control of the litigation were actually a problem, the mere disclosure of a funding arrangement would not solve the problem.

III. The ILR Proposal is Not a True Federal Rules Amendment.

As seen with other amendment proposals, AAJ suspects that this latest proposal is a result of failed lobbying efforts in Congress. Congress has not passed the disclosure requirement, nor should the Advisory Committee. ILR may feel that the threat of Congressional overreach would incentivize Committee action. AAJ acknowledges that there may be times when Congress does step on the Advisory Committee's toes, particularly when circumventing the Rules Enabling Act, but TPLF disclosure is not one of those times.

In his comment (17-CV-FFFFFF), the Chairman of the House Judiciary Committee, Rep. Bob Goodlatte, states that the House included a disclosure requirement for class action cases in H.R. 985, the Fairness in Class Action Litigation Act, and urges the Committee to give careful consideration of 17-CV-O and ultimately support it.[15] H.R. 985 passed the House in March 2017 without any hearings or any support from the minority party. The bill has not gained traction in the Senate, and there is no guarantee that the bill would get considered by the next Congress. Moreover, rules of procedure and evidence should never be dictated by the political whims of Congress. That is why jurists universally approved of the Rules Enabling Act – to remove the creation of rules regarding the administrative of justice away from politicians.

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[13] U.S. Chamber Institute for Legal Reform, *supra* note 6, at 33.
[14] *Id.*
[15] Rep. Bob Goodlatte, Comment 17-CV-FFFFFF (Nov. 1, 2017).

Above all else, the most appropriate body to consider TPLF ethical concerns and potential disclosure requirements is state ethics commissions, not any federal body. While the ILR continues to lobby for third party litigation funding in Congress, ILR has once again asked the Advisory Committee to address a potential state-created ethical problem. AAJ questions whether true ethical concerns can even be addressed by a federal rule change when ethical and conflicts of interest issues are efficiently and effectively regulated by state rules of professional responsibility and licensing.[16]

As ILR's proposal concedes, this is a state issue. In explaining their reasoning for "the need for disclosure," ILR argues that "[t]he funding agreements may violate ***state*** champerty and maintenance laws, as well as ethical canons. . ." (emphasis added).[17] AAJ agrees that if TPLF agreements have any ethical implications at all, they are based on state ethics rules. State ethics commissions would be the appropriate body to consider the ethical implications of TPLF.

The regulation of litigation funding is fundamentally a state issue because it is so closely tied to the rules of professional conduct. The duties an attorney owes to his or her client are also defined by state law and state ethical rules, so issues like disclosure, conflicts of interests, and confidentiality are already regulated by the states.[18] There is simply no need for federal intervention into state rules involving ethics, contracts, and licensing. AAJ would ask the Committee to reject this proposal outright to allow states to continue their work in the evolving world of TPLF.

IV. Attorneys Make Their Own Litigation and Strategy Decisions.

While AAJ disagrees with many statements and notions in ILR's proposal, AAJ wishes to highlight and reiterate AAJ's prior assertions that litigation funders do not interfere with litigation decisions. There is no evidence that the financing company dictates the litigation strategy or decisions. Indeed, legal ethical rules prohibit such interference.[19] There is no reason that an attorney would listen to or take direction from a person or company that has no litigation or trial experience and risk a violation of state ethics rules in the process. Since the proposed amendment from ILR is simply a proposal, AAJ declines to respond to all the points raised in their comments. However, two points require a specific response.

A. Myth: Litigation Funding Deters Settlement.

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[16] *See, e.g.*, State Adoption of the ABA Model Rules of Professional Conduct, ABA Center for Professional Responsibility (2018), *available at* https://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/alpha_list_state_adopting_model_rules.html; *see generally* MODEL RULES OF PROF'L CONDUCT (2016).

[17] U.S. Chamber Institute for Legal Reform, *supra* note 6, at 9.

[18] *See* note 16, *supra*.

[19] Victoria Shannon, *Harmonizing Third-Party Litigation Funding*, 36 CARDOZO LAW REV. 861, 872 (2016) ("According to attorney ethical rules in most states within the United States, the funder must not exercise any control over the legal representation or the attorney. The lawyer representing the underlying client in the case must adhere to any rules of professional responsibility or ethics of the jurisdiction(s) in which she is licensed to practice and may be subject to specific ethical rules of the dispute resolution venue as well.").

ILR alleges that TPLF can delay and distort the settlement process because a party that must repay a TPLF entity a percentage of the proceeds may reject a fair settlement offer and hold out for securing a larger sum of money. The argument is nonsensical. First and foremost, the plaintiffs' attorneys sole concern considering a settlement is the best interest of the client.[20] Even if we were to accept ILR's notion that a plaintiff's attorney unethically considered his or her own interest in repayment over the interest of a client, then because the funding must be repaid, the attorney would arguably be more incentivized to settle at the earliest possible point in the litigation.

ILR's reasoning is not in line with the practical workings of plaintiffs' lawyers. Plaintiffs' lawyers must already weigh the cost and efficiency of trial under the contingency fee system under which most members of the plaintiffs' bar regularly operate. Under the contingency fee system, the plaintiff's attorney must efficiently manage his or her cases. Inefficiency and delay mean that it takes longer for the client to receive compensation, or it may drain the lawyer of their resources to properly bring their case to trial. In contrast, defense attorneys, who charge billable hours, get paid regardless of whether the case is quickly resolved or dragged out and thus do not weigh the cost of continuing litigation to the same extent that a plaintiff's attorney would.

In short, dragging out the settlement process is not financially advantageous to any plaintiffs' attorneys or their clients, and TPLF does not incentivize a plaintiff to reject an early settlement offer. On the other hand, TPLF does ensure that the plaintiff has enough resources to take on a well-heeled defendant. Further, TPLF ensures that a lawyer does not have to accept a low-ball settlement offer or take a complex case to court before it has been fully developed merely because they are running out of litigation resources.[21]

B. Myth: Litigation Funding Undermines Attorney-Client Privilege.

ILR alleges that TPLF raises confidentiality concerns because the attorney may be required to disclose privileged information to the funder. AAJ is amused that that ILR cares whether privilege is violated between injured parties and members of the plaintiffs' bar, when ILR does not represent these interests and offers no examples citing disclosure of privilege or harm to actual clients. A plaintiff's attorney, who is licensed by the state and must follow state ethics rules,[22] is not going to risk censure or the loss of a license by allowing a third party to interfere with the attorney-client relationship. Again, there is no evidence to suggest that current third-party financing practices have breached the obligation for an attorney to zealously represent the client's interests.

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[20] *See, e.g.*, MODEL RULES OF PROF'L CONDUCT R. 1.2, R. 1.3 COMMENT (2016)

[21] *See, e.g.*, Appelbaum, *supra* note 11 (detailing the story of a plaintiff who, when facing an appeal after winning her sexual harassment lawsuit, "needed money for living expenses or she would be forced to take a smaller settlement."); s*ee generally* Jason Krause, *Third-party financing is growing, and lawyers are big players*, ABA Journal (July 2016).

[22] Shannon, *supra* note 20.

V. Conclusion.

AAJ strongly believes that the case for regulation of third-party financing has not been established and that ILR's proposal is just an attempt to unbalance the playing field. There is simply resentment and oftentimes backlash when the plaintiffs' bar secures capital to bring complex cases that are expensive to develop. If any regulation is needed—and there is no evidence that there is—the highest state courts are perfectly capable of performing this function.

AAJ appreciates the opportunity to submit this comment on third-party litigation funding. If you have any questions or comments, please contact Sue Steinman, Senior Director of Policy and Senior Counsel, American Association for Justice, at susan.steinman@justice.org.

Sincerely,

Kathleen L. Nastri
President
American Association for Justice

19-CV-Y

Independent Women's
LAW CENTER

September 20, 2019

Ms. Rebecca A. Womeldorf
Secretary, Committee on Rules of Practice and Procedure
Administrative Office of the United States Courts
One Columbus Circle, NE Washington, D.C. 20544

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

Dear Ms. Womeldorf:

On behalf of the Independent Women's Forum, we write to voice support for the proposal to amend Fed. R. Civ. P. 26(a)(1)(A) to require in civil actions the disclosure of agreements giving a non-party or non-counsel the contingent right to receive compensation from proceeds of the litigation. *See* July 1, 2017 letter to Advisory Committee (Document No. 17-CV-O) (proposing language for a new Fed. R. Civ. P. 26(a)(1)(A)(v)) as supplemented by November 3, 2017 letter to Advisory Committee (Document No. 17-CV-GGGGGG).

We appreciate that the Advisory Committee on Civil Rules (the "Committee") has been actively and carefully considering this proposal. As the Committee continues that important process, we wish to address a troubling assertion the third-party litigation funding ("TPLF") industry has offered in opposition to the proposal.

Advocates for the industry suggest that litigation funding is akin to pro bono practice because TPLF evens up resources between plaintiffs and defendants. As industry advocate Richard Levick puts it, "[t]he pursuit of social justice remains a sub-theme here, an important part of how the financiers see their role in the world."[1] According to Levick, "It's not much of a stretch to see litigation finance, like the plaintiffs' bar itself, filling something of a regulatory function; of forcing businesses to greater accountability where the government has so far failed or declined to do so."[2]

The problem of course is that it *is* a stretch to consider for-profit litigation funders as pro bono enforcement partners. Indeed, the funders take the opposite tact of pro bono attorneys: instead of donating their services, they are highly lucrative for-profit companies with jaw-dropping returns on

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[1] Richard Levick, *Litigation Financing: A Controversial Industry Does Well By Doing Good*, July 1, 2019, https://www.forbes.com/sites/richardlevick/2019/07/01/litigation-financing-a-controversial-industry-does-well-by-doing-good/#73381d106af2.

[2] *Id.*

investment. In 2017, for example, Burford Capital reported a return on equity of 37%.[3] The litigation-financing industry is currently estimated to be worth between $50 and 100 billion.[4]

Nor is litigation financing a narrow scalpel used to go after bad actors. To the contrary, TPLF is an increasingly pervasive practice. According to Burford Capital's 2018 litigation finance survey, 32% of the lawyers they interviewed and an even larger percentage of survey respondents said their firms or companies had used litigation finance—a 237% increase since 2012.[5] And seven in ten U.S. lawyers who have not yet used litigation finance expect to do so within two years.[6]

The industry's private enforcement argument is altogether meritless when, as is increasingly the case, litigation funders purchase cases by the batch. More and more, funders are treating lawsuits like mortgages, investing in a portfolio based on a law firm's "existing track record."[7] In fact, about half of Burford's capital was in case portfolios in 2015.[8] And according to a 2017 Burford survey, more lawyers had experience with portfolio funding in 2016 (9%) than with single case financing in 2013 (7%).[9] The increasing prevalence of portfolio funding by third-party litigation funders makes sense as a diversified investment strategy, but undermines entirely the notion that funders are pro bono advocates for the common good.

To see litigation funders as private enforcers, moreover, gives rise to a whole host of concerns over the use and abuse of the legal process. The argument that for-profit financiers are serving the public interest by funding lawsuits is at odds with centuries of prohibitions on the purchasing of litigation. Under early common law, the courts held that a legal claim could not be transferred to a non-party because of corruption and a fear of multiplying lawsuits and disputes. Indeed, in Medieval England, the justice system was frequently abused when nobles and other parties who had influence with a particular judge would lend their name to a lawsuit. To ensure judicial independence, the doctrine of maintenance thus prohibited non-parties from supporting a lawsuit. Champerty is a specific type of maintenance whereby a third-party supports a lawsuit in return for a share of the profits. TPLF is by definition common law champerty.

The erosion of State law prohibitions against maintenance and champerty has coincided with the rise of judicial independence and the ethical canons that govern attorneys. But the cannons of legal ethics don't apply to third-party financiers and judges often have no knowledge of the funding agreement. As even industry advocates acknowledge, the "only obligations" of third party funders "are the ones stipulated in the contract with their clients."[10] They need not report conflicts or act in the best interest of their clients.

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[3] Brian Baker, *In low-yield environment, litigation finance booms*, Aug. 21, 2018, https://www.marketwatch.com/story/in-low-yield-environment-litigation-finance-booms-2018-08-17.

[4] *Id.*

[5] Burford, *2018 Litigation Finance Survey*, https://www.burfordcapital.com/2018-litigation-finance-survey/.

[6] *Id.*

[7] Sara Randazzo, *Litigation Funding Pioneer Hits a Roadblock*, Wall Street Journal, Nov. 23, 2015, http://blogs.wsj.com/law/2015/11/23/litigation-funding-pioneer-hits-a-roadblock/.

[8] Julie Triedman, *Arms Race: Law Firms and the Litigation Funding Boom*, The American Lawyer, Dec. 30, 2015, http://www.americanlawyer.com/id=1202745121381/Arms-Race-Law-Firmsand-the-Litigation-Funding-Boom.

[9] Burford's Latest Research Shows Explosive Growth and Ongoing Evolution of Litigation Finance, Burford Blog, May 3, 2016.

[10] Richard Levick, *Litigation Financing: A Controversial Industry Does Well By Doing Good*, July 1, 2019, https://www.forbes.com/sites/richardlevick/2019/07/01/litigation-financing-a-controversial-industry-does-well-by-doing-good/#73381d106af2

Third party financiers have one primary objective: to maximize the returns for their investors. This profit motive can put them at odds with their clients and create conflicts of interest. A client may want to settle or not settle. A client may wish for an alternative remedy, like an injunction, or just an apology. These sorts of conflicts also can arise in contingency fee arrangements, which is precisely why judges rigorously police the ethical duty of a lawyer to represent the best interests of his or her client. With respect to TPLF agreements, however, funders are under no similar obligations, and in most cases, the judge is not even made aware of the agreement.

In all events, the TPLF industry never explains why *disclosure* itself is bad policy. Advocates vaguely suggest that disclosure will somehow complicate the industry's "pro bono" mission[11]—but it is hard to see why disclosure of self-styled private enforcers would be a negative thing. If for-profit funders do in fact function like private attorneys general, that is all the more reason to require disclosure. There are numerous safeguards that protect individuals and businesses from the long-arm of federal and state regulators. Similarly, the plaintiffs' bar is subject to canons of judicial ethics that protect the rights of clients and defendants alike.

Moreover, disclosure is important not only to help judges avoid conflicts of interests, make sure common law constraints on champerty and maintenance are not violated, and police the ethical obligations of attorneys, but also to give plaintiffs and defendants access to the same set of settlement tools. Requiring disclosure of TPLF agreements under Rule 26 would provide much needed parity between plaintiffs and defendants. Rule 26 already requires defendants to disclose insurance coverage.[12] As explained in the Advisory Committee Notes, "[d]isclosure of insurance coverage . . . enable counsel for both sides to make the same realistic appraisal of the case, so that settlement and litigation strategy are based on knowledge and not speculation."[13] Similarly, the disclosure of the TPLF agreement would "enable counsel" for the defendant "to make the same realistic appraisal of the case, so that settlement and litigation strategy are based on knowledge and not speculation."[14]

For all of the foregoing reasons, we urge the Committee to recommend adoption of the attached proposed amendment to Fed. R. Civ. P. 26(a)(1)(A). The Advisory Committee's examination of this proposal is greatly appreciated.

Sincerely,

Erin Morrow Hawley
Senior Legal Fellow
Independent Women's Forum

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[11] *See id.*
[12] *See* Fed. R. Civ. P. 26(a)(1)(A)(iv).
[13] Fed. R. Civ. P. 26, Advisory Comm. Notes, 1970 amendment.
[14] *See id.*

Work product protection for legal finance

October 11, 2019 **Andrew Cohen**

In our inaugural Burford Quarterly in 2015, Ernest Getto wrote about the interaction of litigation finance and the protection of attorney work product. The article concluded that "the tide is clearly running in favor of including litigation finance within the umbrella of protection from disclosure—which is certainly the right answer as a policy matter, too." Over the past three years, the law has even more strongly reinforced the protection under the work product doctrine of documents created in connection with litigation finance, or produced to litigation finance providers over the course of diligence and investment.

The work product doctrine, generally speaking, protects from disclosure any materials prepared in anticipation of litigation. As a policy matter, it makes perfect sense: To allow a litigation opponent to obtain an adversary's work product is inimical to the adversarial system as a whole. The protection is so fundamental that, in comparison to the attorney-client privilege, which is typically waived upon disclosure to any third party, the work product protection survives disclosure to third parties, provided that the disclosure does not substantially increase the opportunity for an adverse party to obtain the protected materials.

As applied to the litigation finance context, the analysis is simple. A party seeking financing must provide diligence materials to the potential financier in order to convince the financier that the litigation merits an investment. Those materials, typically, are subject to the work product protection, because they were created for and provided to the potential financier as a consequence of the litigation. Similarly, the deal documents embodying a finance transaction were created because of the litigation, and the terms of such agreements reflect the information provided in work product protected documents, such as lawyers' mental impressions, theories and strategies about the underlying litigation. It follows that documents provided to and created by litigation financiers in the course of diligencing, closing and monitoring a finance transaction should be protected by the work product doctrine. The alternative would create a world where a party needing financing would be faced with a Hobson’s choice of either obtaining the desired capital and turning over its work product to its adversary or foregoing the capital in order to protect its trial strategy and its lawyers’ mental impressions.

As we noted in 2015—and it is even truer today—courts that have considered these issues have overwhelmingly found in favor of extending the work-product “umbrella” to litigation finance providers, and have protected work product provided to litigation financiers from disclosure to adversaries. In addition to the Devon, Mondis, Walker Digital, Miller, Carlyle, and CIT cases we have previously discussed in these pages, a number of decisions have come down recently further solidifying the work product protection as applied to litigation finance documents.

In the IOTC case (In re: Int’l Oil Trading Co., LLC, No. 15-bk-21596 (S.D. Fla. Bankr. Apr. 28, 2016) (order granting in part and denying in part third motion to compel)), a bankruptcy court was faced with motions to compel discovery relating to communications between a creditor and the creditor’s litigation funder (the bankrupt entity was a judgment debtor who had avoided payment for five years). In addition to finding that the communications were protected by the attorney-client privilege (despite the presence of the third-party funder, who was deemed in this situation to share a common interest with the creditor), the court also held that the communications were protected by the work product doctrine. The court explained that communications relating to litigation finance are a link in the chain “in furtherance of rendition of legal services” and thus subject to work product protection. Similarly, the litigation funding agreement itself was subject to work product protection, “as it was entered into with the intent to facilitate litigation.”

The court in Viamedia (Viamedia, Inc. v. Comcast Corp., No. 16-cv-05486 (N.D. Ill. Jun. 30, 2017) (order denying motion to compel)) followed the long line of cases holding that documents disclosed in the course of securing litigation finance remain subject to the work product protection. In denying the motion to compel discovery, the court observed that “while Defendants point out that funders could disclose information to certain individuals and organizations (e.g., their accountants and attorneys), the Court cannot conclude that Viamedia’s disclosure made it substantially more likely that its work-product protected information would fall in the hands of its adversaries.”

This is an important thread that runs through the work product jurisprudence: “[T]he point of the protection is not to keep information secret from the world at large but rather to keep it out of the hands of one’s adversary in litigation.”

More recently, in the Lambeth case (Lambeth Magnetic Structures, LLC v. Seagate Tech. (US) Holdings, Inc., No. 16-cv-00538 (W.D. Pa. Dec. 19, 2017) (order denying motions to compel)), the court extended the work-product protection to communications with potential litigation financiers in the period of time leading up to litigation. Unsurprisingly, the court found that the communications with litigation financiers were for the purpose of preparing for litigation. And because the communications "took place during a period when Lambeth actually and reasonably foresaw litigation," the protection applied.

One reminder of the legal maxim "hard cases make bad law" is the recent order in Acceleration Bay LLC v. Activision Blizzard, Inc., No. 16-cv-00453 (D. Del. Feb. 9, 2018), in which a court upheld a Special Master's order allowing discovery into the plaintiff's communications with a prospective litigation funder, over work product objections. The facts here are messy: Defendants alleged that plaintiffs at first failed to log documents relating to litigation finance, despite a previous order requiring them to be produced. The conversations occurred, according to the court, prior to the litigation having been filed or even the underlying patents having been acquired by the plaintiff, and the court makes no reference to an operative non-disclosure agreement. Perhaps in its eagerness to reach a certain outcome on these facts, the court compounded the bad facts by applying the wrong standard to determine whether the communications were work product—the "primary purpose" test (which applies in the Fifth Circuit) rather than the "because of litigation" test (which applies in the Third Circuit). The result is an outlier opinion, in conflict with the law of the court's own circuit, and in conflict with other Delaware courts.

Outliers notwithstanding, a wealth of caselaw has time and again demonstrated that litigation finance fits squarely within the work product protection. This is the right result as a policy matter, and it is a result that should give comfort to litigants and counsel pursuing litigation finance.

Our author

NEW YORK

Andrew Cohen

Managing Director

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ILFA | INTERNATIONAL LEGAL FINANCE ASSOCIATION

April 7, 2021

Committee on Rules of Practice and Procedure
of the Judicial Conference of the United States
c/o Rules Committee Staff
Administrative Office of the U.S. Courts
Thurgood Marshall Federal Judiciary Building
One Columbus Circle, N.E., Room 7-300
Washington, D.C. 20544

RE: Response to December 22, 2020 Letter from U.S. Chamber Institute for Legal Reform et al. regarding Proposal 17-CV-O

Dear Rules Committee:

The International Legal Finance Association ("ILFA")[1] respectfully submits this response to the December 22, 2020 letter to the Advisory Committee on Civil Rules (the "Committee") from the U.S. Chamber Institute for Legal Reform and Lawyers for Civil Justice (collectively, the "Chamber"). We refer the Advisory Committee to the previous submissions of some of ILFA's founding members[2] and only briefly address the substance of this latest communication.

Once again, as it did in 2014, 2015, 2017, 2018, and 2019, the Chamber urges the Committee to adopt its proposal to force disclosure of funding arrangements in every civil case under Fed. R. Civ. P. 26(a)(1)(A). However, this Committee and the MDL Subcommittee have extensively studied and rejected the Chamber's approach at every point after countless hearings, receipt of testimony, feedback from members of the bar, and consideration of documentary and related information from ILFA's members, the Chamber and other interested parties. Despite this, the Chamber somehow asserts anew that the Committee's extensive factfinding and research efforts on this topic have fallen short.

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[1] Founded in September 2020, the International Legal Finance Association is the only global association of commercial legal finance companies. ILFA is a non-profit trade association that promotes the highest standards of operation and service for the commercial legal finance sector. Its founding members include Burford Capital, Omni Bridgeway (formerly known as Bentham IMF), and Therium Capital Management, which previously participated in the Committee's deliberations regarding legal finance.

[2] Letter from Eric H. Blinderman, Chief Executive Officer (U.S.), Therium Capital Management, Allison K. Chock, Chief Investment Officer, Bentham IMF, and Danielle Cutrona, Director, Global Public Policy, Burford Capital, to Rebecca A. Womeldorf, Secretary, Committee on Rules of Practice and Procedure, Administrative Office of the U.S. Courts (Feb. 20, 2019); Letter from Christopher P. Bogart, Chief Executive Officer, Burford Capital, to Rebecca A. Womeldorf, Secretary, Committee on Rules of Practice and Procedure, Administrative Office of the U.S. Courts (Feb. 20, 2019); Letter from Allison K. Chock, Chief Investment Officer, Bentham IMF, to Rebecca A. Womeldorf, Secretary, Committee on Rules of Practice and Procedure, Administrative Office of the U.S. Courts (Sept. 6, 2017); Letter from Christopher P. Bogart, Chief Executive Officer, Burford Capital, to Rebecca A. Womeldorf, Secretary, Committee on Rules of Practice and Procedure, Administrative Office of the U.S. Courts (Sept. 1, 2017); Letter from Adam R. Gerchen, Chief Executive Officer, Gerchen Keller Capital, LLC, Christopher P. Bogart, Chief Executive Officer, Burford Capital, and Ralph J. Sutton, Chief Investment Officer, Bentham IMF, to Jonathan C. Rose, Secretary, Advisory Committee on the Rules of Practice and Procedure, Administrative Office of the U.S. Courts (Oct. 21, 2014).

The Chamber offers the same arguments as in each of its previous submissions regarding control and ethical obligations, which are simply wrong and no more persuasive today than they were then. Moreover, not only has nothing changed to justify revisiting the Committee's decisions, but legal developments since this issue was last considered have only reinforced the Committee's prior decisions:

No federal court has required mandatory disclosure of financing in litigation on a scale equivalent to the Chamber's proposal. Contrary to the Chamber's flawed arguments that disregard well-developed jurisprudence in this area, federal courts have routinely rejected discovery regarding the sources of financing in litigation unless the party seeking it makes a specific showing of relevance.[3] Indeed, federal courts have only permitted discovery in exceedingly rare and unique circumstances where it is, in fact, germane to the claims and defenses of the parties. The call for blanket forced disclosure under Rule 26 flies in the face of this settled judicial consensus and the principles of relevance and proportionality.

The Chamber's proposal also continues to ignore a related and critical factor of which the Committee is aware: federal courts easily can and do handle these discovery issues under existing Rule 26 and/or their own inherent authority. As the Committee appropriately observed in rejecting earlier calls for the same Rule 26 amendment, "judges currently have the power to obtain information about third-party funding when it is relevant in a particular case."[4] Judge Polster's order in the pending Opioids MDL in the U.S. District Court for the Northern District of Ohio is a perfect example.[5] Other federal courts have adopted this sensible approach, which balances the court's need to inquire into financing arrangements for a specific, narrow purpose with the fact that funding issues are rarely relevant to the parties' claims and defenses.[6]

There is also a growing recognition of the need to consider rules to permit nonlawyer participation in the delivery of legal services. Quite the opposite of the Chamber's contentions, the momentum in many jurisdictions is toward allowing and endorsing broader access to legal finance. A number of states are in various stages of consideration and implementation of rules to permit the delivery of legal services by nonlawyers and nonlawyer law firm ownership.[7] In

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[3] *See Colibri Heart Valve LLC v. Medtronic CoreValve LLC, et al.*, Case No. 8:20-cv-00847 (C.D. Cal. Mar. 26, 2021) (finding legal finance documents not discoverable; defendant's "skepticism" that plaintiff's discovery responses were not accurate or complete did not demonstrate the requisite relevance of the funding documents to the claims and defenses in the matter); *MLC Intellectual Prop., LLC v. Micron Tech., Inc.*, No. 14-cv-03657, 2019 WL 118595, at *2 (N.D. Cal. Jan. 7, 2019) (finding that defendant's attempts to establish relevance based on potential bias and conflicts of interest concerns were speculative); *Miller UK Ltd. v. Caterpillar, Inc.*, 17 F. Supp. 3d 711, 724 (N.D. Ill. 2014) (rejecting discovery into legal finance arrangements; noting defendant's assertion of relevance lacked "any cogency"); *VHT, Inc. v. Zillow Group, Inc.*, No. C15-1096JLR, 2016 WL 7077235, at *1 (W.D. Wash. Sept. 8, 2016) (rejecting discovery into legal finance arrangements absent "some objective evidence that any of Zillow's theories of relevance apply in this case").

[4] Hon. David G. Campbell, Report of Advisory Committee on Civil Rules, at 4 (Dec. 2, 2014), available at https://www.uscourts.gov/sites/default/files/fr_import/CV12-2014.pdf.

[5] *See In re Nat'l Prescription Opiate Litig.*, No. 1:17-MD-2804, 2018 WL 2127807, at *1 (N.D. Ohio May 7, 2018) (ordering all counsel to submit a description of any third-party funding for *in camera* review, as well as affirmations that any funding obtained did not create conflicts or cede case control).

[6] *See, e.g., Micron*, 2019 WL 118595, at *2 (noting the court's ability to "question potential jurors *in camera* regarding relationships to third party funders and potential conflicts of interest" if necessary at trial).

[7] *See, e.g.*, Press release, "Arizona Supreme Court Makes Generational Advance in Access to Justice." *Arizona Supreme Court, Administrative Office of the Courts,* 27 Aug. 2020, https://www.azcourts.gov/Portals/201/Press%20Releases/2020Releases/082720RulesAgenda.pdf; State Bar of

February 2020, the ABA's House of Delegates went so far as to pass a resolution calling for "regulatory innovations that have the potential to improve the accessibility, affordability, and quality of legal services."[8] Likewise, the Conference of Chief Justices passed a similar resolution, citing "consideration of alternative business structures" as an area for consideration.[9]

In short, the Chamber is continuing to advocate for a considerable departure from existing rules governing discovery and moreover, proposes to direct the method and manner by which the Committee should determine whether its proposal is necessary. Such an approach ignores the years of research that the Committee has spent investigating this issue and reaffirms the Chamber's desperate search for information to define a problem that only it is certain exists.

Indeed, having begged the question that legal finance is a problem, the Chamber thereby acknowledges that this latest effort is simply another attempt at a fishing expedition. ILFA stands ready to assist the Committee in legitimate fact-finding exercises to the extent actually warranted, however, we note that there is nothing in the Chamber's latest submission which would justify such an inquiry. Belying this obvious conclusion is the fact that the Chamber's own members are users of legal finance.[10] As such, the Chamber could easily conduct an internal survey of its members who could waive privilege if they choose to reply as opposed to seeking such privileged and confidential information[11] from ILFA's members under the guise of a Committee-mandated "mini questionnaire."

For the foregoing reasons, and for all the reasons we have stated in our previous submissions to the Committee, we respectfully submit that the Chamber's renewed request does not merit this Committee's reconsideration.

California, "State Bar of California Task Force on Access Through Innovation of Legal Services: Final Report and Recommendations," Mar. 6, 2020, http://www.calbar.ca.gov/Portals/0/documents/publicComment/ATILS-Final-Report.pdf; Press release, "D.C. Bar Global Legal Practice Committee Seeks Public Comment on Rule of Professional Conduct 5.4." *DC Bar,* 23 Jan. 2020, https://www.dcbar.org/news-events/news/d-c-bar-global-legal-practice-committee-seeks-publ; Press release, "To Tackle the Unmet Legal Needs Crisis, Utah Supreme Court Unanimously Endorses a Pilot Program to Assess Changes to the Governance of the Practice of Law." *State of Utah Judicial Council, Administrative Office of the Courts,* 13 Aug. 2020, https://www.utahbar.org/wp-content/uploads/2020/08/Regulatory-Order-PR-8-20.pdf. *See also* Regulatory Innovation Working Group, Commission to Reimagine the Future of New York's Courts, "Report and Recommendations of the Working Group on Regulatory Innovation" (Dec. 3, 2020) (offering broad support for legal finance and noting that Rule 5.4 of the New York Rules of Professional Conduct, which prohibits fee-sharing between lawyers and nonlawyers, should be revised to ensure greater access to legal finance).

[8] American Bar Association, Resolution 115, https://www.americanbar.org/content/dam/aba/administrative/news/2020/02/midyear2020resolutions/115.pdf.

[9] Conference of Chief Justices, Resolution 2: Urging Consideration of Regulatory Innovations Regarding the Delivery of Legal Services, https://www.ncsc.org/__data/assets/pdf_file/0010/23500/02052020-urging-consideration-regulatory-innovations.pdf.

[10] Letter from Eric H. Blinderman, Chief Executive Officer (U.S.), Therium Capital Management, Allison K. Chock, Chief Investment Officer, Bentham IMF, and Danielle Cutrona, Director, Global Public Policy, Burford Capital, to Rebecca A. Womeldorf, Secretary, Committee on Rules of Practice and Procedure, Administrative Office of the U.S. Courts (Feb. 20, 2019); Letter from Christopher P. Bogart, Chief Executive Officer, Burford Capital, to Rebecca A. Womeldorf, Secretary, Committee on Rules of Practice and Procedure, Administrative Office of the U.S. Courts (Feb. 20, 2019).

[11] *See, e.g., Miller UK Ltd.*, 17 F. Supp. 3d at 734-35 ("For purposes of a privilege analysis, there is nothing unique about cases involving third party litigation funding. . . . Materials that contain counsel's theories and mental impressions . . . do not necessarily cease to be protected because they may also have been prepared or used to help [a party] obtain financing."); *Impact Engine, Inc. v. Google LLC*, Case No. 3:19-cv-01301-CAB-DEB (S.D. Cal. Oct. 20, 2020) (finding funding documents not discoverable based on the attorney work product doctrine); *Continental Circuits LLC v. Intel Corp.*, 435 F.Supp.3d 1014, 1020-21 (D. Ariz. 2020) (same).

Respectfully submitted,

/s/

Shannon Campagna
Executive Director

RULES SUGGESTION
to the
ADVISORY COMMITTEE ON APPELLATE RULES

PERVASIVE, YET UNKNOWN: THE PREVALENCE OF DIRECT, UNDISCLOSED NON-PARTY FINANCIAL STAKES IN APPELLATE OUTCOMES, AND WHY THE COMMITTEE SHOULD AMEND RULE 26.1

September 1, 2022

Lawyers for Civil Justice ("LCJ")[1] respectfully submits this Rule Suggestion to the Advisory Committee on Appellate Rules ("Committee").

Introduction

Direct, yet undisclosed non-party financial stakes in appellate outcomes are pervasive in federal circuit courts. These concrete rights—typically, a right to receive a percentage of proceeds contingent on the court's decision to uphold a judgment—arise from litigation funding contracts and popular "crowdfunding" web sites. Such rights can be held by individuals, investment funds (including family offices), and institutions, both domestic and non-US. Unfortunately, circuit judges are largely unaware that such non-party interests are present in the cases they decide. Rule 26.1 of the Federal Rule of Appellate Procedure does not require disclosure of these financial arrangements and therefore does not assist judges in determining whether they pose potential conflicts of interest or create the appearance of impropriety. Local rules do not do so either; although six of the twelve circuit local disclosure rules are broad enough to include such rights, none of them specifically mentions non-party rights created by funding contracts—an oversight that litigation funders rely upon to conclude that those rules do not apply to their financial stakes. Closing this disclosure gap would be consistent with the Chief Justice's recent call for "greater attention to promoting a culture of compliance" in the federal judiciary,[2] which

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[1] LCJ is a national coalition of corporations, law firms, and defense trial lawyer organizations that promotes excellence and fairness in the civil justice system to secure the just, speedy, and inexpensive determination of civil cases. For over 35 years, LCJ has been closely engaged in reforming federal procedural rules in order to: (1) promote balance and fairness in the civil justice system; (2) reduce costs and burdens associated with litigation; and (3) advance predictability and efficiency in litigation.

[2] John G. Roberts, Jr., Chief Justice of the United States, *2021 Year-End Report on the Federal Judiciary*, at 3-4, https://www.supremecourt.gov/publicinfo/year-end/2021year-endreport.pdf.

was inspired by the *Wall Street Journal*'s reporting of 685 instances of conflicts of interest.[3] Amending Rule 26.1 to cover non-party outcome-contingent rights to share in the proceeds of litigation matters is necessary to provide judges adequate, uniform disclosures.[4]

I. Undisclosed Non-Party Financial Rights Are Commonplace in Appellate Cases

There are $11 billion worth of non-party financial rights in litigation outcomes in the United States today, according to a recent survey.[5] Such rights exist for litigation at all stages[6]—including appeals[7]—in all federal courts and in cases of a wide variety of subject matters. Appellate cases "seem[] to be a significant sub-category of litigation funding,"[8] according to the Advisory Committee on Civil Rules, which has been studying the matter since 2014. These financial rights are held by individuals, asset managers (including family offices), hedge funds, and institutions,[9] including both non-US individuals[10] and sovereign wealth funds.[11]

II. The Financial Rights Held by Non-Party Investors Are Directly Contingent on the Outcome of Appeals

The financial rights that non-party litigation investors receive in exchange for their investments are directly contingent upon the outcome of cases. Litigation finance "is the practice where a third party unrelated to the lawsuit provides capital to a plaintiff involved in litigation in return for a portion of any financial recovery from the lawsuit."[12] These are not loans. Litigation finance provider LexShares explains:

> Solutions are instead structured as non-recourse investments, which means that the funding recipient owes nothing if the lawsuit does not result in a recovery. If the case reaches a

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[3] *Id*. at 3.

[4] The Committee is separately devoting attention to considering whether to require more disclosures from amici curiae. The need for disclosure about non-party financial rights contingent on the outcome of an appeal is far more compelling. Non-parties with financial rights that are directly contingent in the outcome of an appeal are akin to real parties in interest, and are far different from ordinary members of an advocacy organization or trade association that publicly files an amicus brief, thus identifying their group as interested in the appeal. Litigation funds are completely unknown to the court.

[5] Bloomberg Law, *Willkie, Longford Reach $50 Million Litigation Funding Pact* (June 23, 2021), https://news.bloomberglaw.com/business-and-practice/willkie-longford-partner-in-50-million-litigation-funding-pact ("[L]itigation funding . . . has attracted more than $11 billion in capital, according to a survey this year."). In 2021, a single company, Burford, committed over a billion dollars to fund litigation. Burford Capital 2021 Annual Report, at iv, https://www.burfordcapital.com/media/2679/fy-2021-report.pdf ("Burford 2021 Annual Report"); *see also* Christopher Bogart, *Common sense vs. false narratives about litigation finance disclosure*, Burford Capital (July 12, 2018), https://www.burfordcapital.com/insights/insights-container/common-sense-vs-false-narratives-about-litigation-finance-disclosure/ ("Burford Article") ("[L]itigation finance continues to grow as an increasingly essential tool to law firms and litigants.").

[6] LexShares, Frequently asked questions, https://www.lexshares.com/faqs ("LexShares FAQs").

[7] *See* Appeal Funding Partners, https://appealfundingpartners.com/.

[8] Advisory Committee on Civil Rules, Agenda Book, at 381 (Oct. 5, 2021).

[9] LexShares FAQs ("LexShares investors include high net worth individuals and institutional investors, including select family offices, hedge funds and asset managers.").

[10] *Id.* ("LexShares supports funding by non U.S. based investors through our online platform").

[11] Burford 2021 Annual Report at 12.

[12] LexShares, Litigation Finance 101, https://www.lexshares.com/litigation-finance-101.

> positive outcome, then the funding recipient would owe a predetermined portion of any damages recovered.[13]

Another large litigation financing firm, Burford, similarly explains:

> In return [for our investment], we receive our contractually agreed entitlement from the ultimate settlement or judgment on the claim and, if the claim does not produce any cash proceeds, we generally lose our capital.[14]

The nature of investors' financial rights is the same in appellate cases, as a firm specializing in appellate investments, Appeal Funding Partners, explains:

> An Appeal Funding cash advance is not a loan. It is an investment in a portion of a judgment on appeal. . . . In this regard, our goals and yours are perfectly aligned. *If you win, we win*. And you have the added security of knowing that if the case is eventually lost, you keep every dollar we advanced to you and you owe us nothing. If the case is ultimately won, we all win.[15]

Because the non-party financial entitlements that we are describing are directly dependent on the outcome of cases, and because there are no countervailing interests in nondisclosure of this information,[16] judges should know when they are present.

III. Circuit Judges Should Be Able to Determine Whether Financial Rights Contingent on the Outcome of Appeals Pose a Conflict of Interest

Circuit judges are required by statute,[17] the Code of Conduct for Federal Judges,[18] and the Judicial Conference Mandatory Conflict Screening Policy[19] to recuse themselves when they know that they have a financial interest that would be substantially affected by the outcome of the proceeding. This responsibility applies to financial interests "however small"[20] and extends to include any "appearance of impropriety."[21] Compliance with these provisions requires judges

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[13] *Id.*

[14] Burford 2021 Annual Report at 13.

[15] Appeal Funding Partners, Our Solutions, https://appealfundingpartners.com/our-solutions/ (emphasis added).

[16] By contrast to the funding at issue here, the U.S. Supreme Court has recognized the First Amendment prohibits "compelled disclosure of affiliation with groups engaged in advocacy" where the government has "no offsetting interest 'sufficient to justify the deterrent effect' of [such] disclosure." *See Ams. for Prosperity Found. v. Bonta*, 141 S. Ct. 2373, 2382 (2021) (citation omitted). It has counseled, "Protected association furthers 'a wide variety of political, social, economic, educational, religious, and cultural ends,' and 'is especially important in preserving political and cultural diversity and in shielding dissident expression from suppression by the majority. . . . [I]t is hardly a novel perception that compelled disclosure of affiliation with groups engaged in advocacy may constitute as effective a restraint on freedom of association as [other] forms of governmental action." *Id.* (citations omitted).

[17] 28 U.S.C. § 455.

[18] Code of Conduct for Federal Judges, Canon 3(C)(1)(c).

[19] U.S. Courts, Guide to Judiciary Policy, Mandatory Conflict Screening Policy, https://www.uscourts.gov/sites/default/files/guide-vol02c-ch04.pdf (last revised Mar. 15, 2022).

[20] Code of Conduct for Federal Judges, Canon 3(C)(3)(c).

[21] Code of Conduct for Federal Judges, Canon 2.

to be able to discover when non-party individuals, asset managers, and funds have contingent rights in proceeds triggered by the outcomes of appeals that they are handling.

IV. Rule 26.1 Should Be Amended to Provide Circuit Judges the Disclosures Necessary to Determine Whether Outcome-Contingent Non-Party Financial Entitlements Pose Conflicts of Interest

The purpose of Rule 26.1 is to "assist[] a judge in ascertaining whether or not the judge has an interest that should cause the judge to recuse himself or herself from the case," according to the 1998 Committee Notes.[22] But the Rule says nothing about potential non-party financial rights, even where those interests are directly affected by the outcome of the case. It merely requires that "[a]ny nongovernmental corporation that is a party to a proceeding in a court of appeals must file a statement that identifies any parent corporation and any publicly held corporation that owns 10% or more of its stock or states that there is no such corporation."[23] To assist circuit judges in obtaining the information required to ascertain whether any potential non-party financial rights exist in the case, the Rule should be amended to require disclosure of non-party financial rights that are directly contingent upon the outcome of the appeal. Such an amendment would be consistent with the current Rule's focus on interests that are concretely affected by the outcome of an appeal; as the 1998 Committee Notes explain, "disclosure of entities that would *not* be adversely affected by a decision in the case is unnecessary."[24]

V. Circuit Local Rules are Inconsistent, Unclear, and Not Specific Enough to Encompass the Commonplace Non-Party Financial Entitlements Held by Litigation Investors

The variation in circuits' local rules on this subject further highlights the case for amending Rule 26.1 to create a uniform rule requiring disclosure of non-party financial rights contingent on the outcome of appeals.[25] Six circuits generally require disclosure of "all persons" or "other legal entities" that "are financially interested in the outcome of the litigation."[26] But because those rules do not specifically mention rights created by litigation financing contracts, some holders of these entitlements interpret the rules not to apply. Burford explains:

> Six out of 12 federal circuit courts of appeal have local variations on Rule 26.1 that additionally require outside parties with a financial interest in the outcome to be disclosed. None of these rules, however, singles out litigation finance providers for disclosure . . . .[27]

The result is today's lack of disclosure of such arrangements. In Burford's words: "[T]hese broad disclosure provisions in local rules do not appear to be much-followed or enforced."[28]

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[22] Fed. R. App. P. 26.1 committee notes to 1998 amendment.

[23] Fed. R. App. P. 26.1(a).

[24] Fed. R. App. P. 26.1 committee notes to 1998 amendment.

[25] Memorandum from Patrick A. Tighe, Rules Law Clerk, to Ed Cooper, Dan Coquillette, Rick Marcus, and Cathie Struve, *Survey of Federal and State Disclosure Rules Regarding Litigation Funding* (Feb. 7, 2018), *in* Advisory Committee on Civil Rules, Agenda Book, at 209 (Apr. 10, 2018).

[26] *See, e.g.*, 5th Cir. R. 28.2.1.

[27] Burford Article.

[28] *Id.*

Accordingly, amending Rule 26.1 to provide an explicit, uniform[29] disclosure standard for non-party outcome-contingent financial entitlements—and specifically mentioning rights to settlement or judgment proceeds that stem from litigation investment arrangements—is necessary for judges to determine whether such rights pose a conflict of interest in their cases.

Conclusion

Rule 26.1 is failing to provide circuit judges any information about the non-party, outcome-contingent financial rights that are commonplace in appellate cases today. Because circuit judges are responsible for determining whether such interests pose a conflict of interest, Rule 26.1's omission hampers the Judicial Conference's goal of promoting a greater "culture of compliance" in the judiciary. The various local disclosure rules have not proven an adequate substitute. The Committee should thus amend Rule 26.1 to require disclosure of non-party outcome-contingent rights to settlement or judgment proceeds tied to the outcome of cases, specifically including such interests arising from litigation investment contracts.

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[29] The 1989 Committee Notes to Rule 26.1 invited circuits to develop local disclosure rules, but stated: "However, the committee requests the courts to consider the desirability of uniformity and the burden that varying circuit rules creates on attorneys who practice in many circuits." Fed. R. App. P. 26.1 advisory committee notes (1989 addition).

RULES SUGGESTION
to the
ADVISORY COMMITTEE ON CIVIL RULES

AN IMPORTANT BUT RARELY ASKED QUESTION: AMENDING RULE 16(c)(2) TO PROMPT JUDGES TO CONSIDER INQUIRING ABOUT FINANCIAL INTERESTS CREATED BY THIRD-PARTY LITIGATION FUNDING

September 8, 2022

Lawyers for Civil Justice ("LCJ")[1] and the U.S. Chamber of Commerce Institute for Legal Reform ("ILR")[2] respectfully submit this Rule Suggestion to the Advisory Committee on Civil Rules ("Committee").

Introduction

Many federal judges are presiding over lawsuits in which, unbeknownst to the court, a non-party investor has a direct, contingent financial interest in the proceeds produced by any judgment or settlement due to third-party litigation funding—commonly abbreviated as TPLF. Although judges are required to recuse themselves when they know that they or their families have a financial stake in a case, courts remain largely in the dark about the existence of third-party investments in their cases. This is so because the existence of TPLF in a given case need not be disclosed as a matter of course under the Federal Rules of Civil Procedure, and to the extent local rules require the disclosure of direct financial interests, they have largely been ignored. Although the District of New Jersey recently adopted a local rule expressly requiring the disclosure of TPLF-related information at the outset of a case,[3] and certain individual judges[4] have instituted standing rules requiring similar information in their own cases, most judges have no idea whether interests created by TPLF are at play in litigation they are overseeing.

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[1] LCJ is a national coalition of corporations, law firms, and defense trial lawyer organizations that promotes excellence and fairness in the civil justice system to secure the just, speedy, and inexpensive determination of civil cases. For over 35 years, LCJ has been closely engaged in reforming federal procedural rules in order to: (1) promote balance and fairness in the civil justice system; (2) reduce costs and burdens associated with litigation; and (3) advance predictability and efficiency in litigation.

[2] ILR is a program of the Chamber dedicated to championing a fair legal system that promotes economic growth and opportunity. The Chamber is the world's largest business federation, representing the interests of more than three million businesses of all sizes, sectors and regions, as well as state and local chambers and industry associations, and it is dedicated to promoting, protecting and defending America's free enterprise system.

[3] *See* D.N.J. L. Civ. R. 7.1.1, https://www.njd.uscourts.gov/sites/njd/files/completelocalRules.pdf. The Northern District of California has also adopted its own TPLF disclosure requirement for class actions. *See* Standing Order for all Judges of the Northern District of California, Contents of Joint Case Management Statement, § 19, https://www.cand.uscourts.gov/wp-content/uploads/judges/Standing_Order_All_Judges_11.1.2018.pdf ("N.D. Cal. Standing Order").

[4] Chief Judge Colm F. Connolly of the District of Delaware recently issued a standing order requiring "[a] brief description of the nature of the financial interest" held by any non-party investor in the matters before him. Standing Order Regarding Third-Party Litigation Funding Arrangements, § 1(c), https://www.ded.uscourts.gov/sites/ded/files/Standing%20Order%20Regarding%20Third-Party%20Litigation%20Funding.pdf.

Although a uniform TPLF disclosure rule applicable to all civil cases, as described in Rule Suggestion 17-CV-O,[5] would be the most effective way to inform courts and parties about TPLF and the financial interests it creates, an amendment to Rule 16(c)(2)—specifically, the addition of TPLF as a matter for consideration during pretrial conferences—would be very helpful to courts and parties alike. Such a change would help alert judges to the issues of TPLF and facilitate discussion (and potential disclosure) of the non-party stakes in their cases. Some judges may appreciate the addition to Rule 16(c)(2) as befitting the Chief Justice's recent call for "greater attention to promoting a culture of compliance" in the federal judiciary,[6] particularly on the "matter of financial disclosure and recusal obligations,"[7] which was inspired by the *Wall Street Journal*'s reporting of 685 instances of conflicts of interest.[8] Some judges may value a nudge for reasons beyond their ethical duties, including to learn who should participate in settlement conferences due to their authority or influence over resolution decisions. And some judges may appreciate the signal to learn facts relevant to their understanding of "the parties' resources" as required by Rule 26(b)(1), fashioning appropriate sanctions, and allocating costs. There are other case-specific reasons as well.[9] For the Committee, adding such a prompt to Rule 16(c)(2) would provide meaningful assistance to judges while sidestepping all of the drafting questions that have complicated its contemplation of a TPLF disclosure rule applicable to all cases. In short, a Rule 16(c)(2) reference to TPLF would assist judges who may find good reasons to inquire about the presence of non-party financial rights to proceeds in their cases while still preserving their complete discretion to make that decision only when appropriate on a case-by-case basis.

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[5] *See* https://www.uscourts.gov/sites/default/files/17-cv-o-suggestion_ilr_et_al_0.pdf.

[6] John G. Roberts, Jr., Chief Justice of the United States, *2021 Year-End Report on the Federal Judiciary*, at 3-4, https://www.supremecourt.gov/publicinfo/year-end/2021year-endreport.pdf.

[7] *Id*. at 3.

[8] *Id*.

[9] Recently filed complaints in the ongoing bankruptcy proceeding involving recently disbarred plaintiffs' attorney Thomas Girardi and his law firm, Girardi Keese, highlight some additional reasons why a judge may want to inquire about TPLF in particular cases. According to the first complaint, the orphans and widows of the victims of the Lion Air Flight 610 plane crash allege that certain litigation funders improperly took money that belonged to Girardi's clients. *See generally* Compl., *Ruigomez v. Miller (In re Girardi Keese)*, No. 2:20-bk-21022-BR, ECF No. 1329 (Bankr. C.D. Cal. filed Aug. 30, 2022). And the second complaint – filed by the Trustee appointed to manage the Girardi bankruptcy estate – alleges that Girardi and his law firm not only siphoned money from their clients, but also did so with the knowledge of litigation funders, improperly shared fees with those entities in contravention of Rule 5.4, and were essentially "implied in fact" partners or "insiders" of Girardi Keese. *See* Compl. ¶ 11, *Miller v. Counsel Fin. Servs., LLC (In re Girardi Keese)*, No. 2:20-bk-21022-BR, ECF No. 1333 (Bankr. C.D. Cal. filed Aug. 31, 2022).

I. Undisclosed TPLF Arrangements Are Commonplace.

In many federal civil lawsuits, non-parties to the litigation (i.e., investors)—including individuals (both U.S. and non-U.S. citizens[10]), investment funds (including family offices[11]), hedge fund investors, and foreign countries' sovereign wealth funds[12]—hold legal rights to a portion of any proceeds from the case. These interests derive from investment contracts not only with single-purpose litigation funders, but also in conjunction with mainstream financial institutions, investment advisors, and popular "crowdfunding" websites. Investing in litigation outcomes is a multi-billion-dollar industry in the United States; a recent survey indicates that the value of such investments reached $11 billion this year,[13] and a single company committed more than $1 billion in 2021 alone.[14] Non-party financial stakes exist at all stages of civil litigation,[15] in all federal courts, and in cases regarding a wide variety of subject matters.

The nature of these direct financial interests held by non-party litigation investors is well-known: They are completely dependent on the outcome of the case. Litigation finance "is the practice where a third party unrelated to the lawsuit provides capital to a plaintiff involved in litigation in return for a portion of any financial recovery from the lawsuit."[16] These are not loans. Litigation finance provider LexShares explains:

> Solutions are instead structured as non-recourse investments, which means that the funding recipient owes nothing if the lawsuit does not result in a recovery. If the case reaches a positive outcome, then the funding recipient would owe a predetermined portion of any damages recovered.[17]

Another large litigation financing firm, Burford, similarly observes:

> In return [for our investment], we receive our contractually agreed entitlement from the ultimate settlement or judgment on the claim and, if the claim does not produce any cash proceeds, we generally lose our capital.[18]

As another litigation financer explains to parties: "If you win, we win."[19] In short, there is no dispute that outside litigation funders are increasingly acquiring direct pecuniary interests in the

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[10] LexShares Frequently asked questions, https://www.lexshares.com/faqs ("LexShares FAQs") ("LexShares supports funding by non U.S. based investors through our online platform.").
[11] *Id.* ("LexShares investors include high net worth individuals and institutional investors, including select family offices, hedge funds and asset managers.").
[12] Burford Capital 2021 Annual Report, at 12, https://www.burfordcapital.com/media/2679/fy-2021-report.pdf ("Burford 2021 Annual Report").
[13] Bloomberg Law, *Willkie, Longford Reach $50 Million Litigation Funding Pact* (June 23, 2021), https://news.bloomberglaw.com/business-and-practice/willkie-longford-partner-in-50-million-litigation-funding-pact ("[L]itigation funding . . . has attracted more than $11 billion in capital, according to a survey this year.").
[14] Burford 2021 Annual Report at iv ("We wrote $1.1 billion in group-wide new commitments in 2021, and we deployed $841 million in cash during the year.").
[15] LexShares FAQs.
[16] LexShares, Litigation Finance 101, https://www.lexshares.com/litigation-finance-101.
[17] *Id.*
[18] Burford 2021 Annual Report at 13.
[19] Appeal Funding Partners, Our Solutions, https://appealfundingpartners.com/our-solutions/.

outcome of civil cases. However, there is presently no mechanism for even raising the question of TPLF in a particular case, much less obtaining information as to whether (and, if so, how) TPLF is impacting that case.

II. A Rule 16(c)(2) Prompt Would Help Courts Decide Whether To Raise TPLF For Discussion Or Ask For Disclosure.

a. A Rule 16(c)(2) Amendment Would Help Mitigate Conflicts Of Interest.

Judges are bound by statute,[20] the Code of Conduct for Federal Judges,[21] and the Judicial Conference's Mandatory Conflict Screening Policy,[22] to recuse themselves when they know that they have a financial interest that would be substantially affected by the outcome of the proceeding. This responsibility applies to financial interests, "however small,"[23] and extends to include any "appearance of impropriety."[24] To assist this determination, Rule 7.1 requires disclosure of any parent corporation that owns 10 percent or more of a corporate party's stock.[25] Unfortunately, Rule 7.1 does not require disclosure of any direct non-party financial stakes, even when those rights are directly tied to the outcome of the case. And, for the most part, local rules do not specifically address this deficiency, not only because they vary dramatically from district to district,[26] but also because litigation funders do not believe they apply to their activities. According to Burford, one of the largest litigation funders: "[T]hese broad disclosure provisions in local rules do not appear to be much-followed or enforced."[27]

Conflicts of interest are not theoretical; they happen. And they can arise even though district judges are (presumably) not personally investing with entities explicitly advertising themselves as "litigation funders." Judges or their family members may have financial or other entanglements with people or entities (including "crowdfunding" websites) that are making such investments. One example is a racketeering suit arising out of misconduct by attorney Steven Donziger, who had helped secure an $18.2 billion judgment against Chevron Corporation on behalf of Ecuadorians allegedly harmed by the company's oil drilling practices.[28] During a deposition in that proceeding, Donziger was asked to identify the company that had helped finance the underlying suit against Chevron.[29] Upon being ordered to answer the question by the

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[20] 28 U.S.C. § 455.

[21] Code of Conduct for Federal Judges, Canon 3(C)(1)(c).

[22] U.S. Courts, Guide to Judiciary Policy, Mandatory Conflict Screening Policy, https://www.uscourts.gov/sites/default/files/guide-vol02c-ch04.pdf (last revised Mar. 15, 2022).

[23] Code of Conduct for Federal Judges, Canon 3(C)(3)(c).

[24] Code of Conduct for Federal Judges, Canon 2.

[25] Fed. R. Civ. P. 7.1.

[26] Memorandum from Patrick A. Tighe, Rules Law Clerk, to Ed Cooper, Dan Coquillette, Rick Marcus, and Cathie Struve, *Survey of Federal and State Disclosure Rules Regarding Litigation Funding* (Feb. 7, 2018), *in* Advisory Committee on Civil Rules, Agenda Book, at 209 (Apr. 10, 2018).

[27] Christopher Bogart, *Common sense vs. false narratives about litigation finance disclosure*, Burford Capital (July 12, 2018), https://www.burfordcapital.com/insights/insights-container/common-sense-vs-false-narratives-about-litigation-finance-disclosure/ ("Burford Article") ("[T]hese broad disclosure provisions in local rules do not appear to be much-followed or enforced.").

[28] Jennifer A. Trusz, *Full Disclosure? Conflicts of Interest Arising from Third-Party Funding in International Commercial Arbitration*, 101 Geo. L.J. 1649, 1650 (2013).

[29] *Id.*

special master assigned to the case, Donziger disclosed that the funder was Burford Capital.[30] The special master then disclosed that he was former co-counsel with the founder of Burford, who once sent the special master a brochure about funding one of Burford's cases,[31] and that he was friends with Burford's former general counsel.[32] The special master did not recuse himself from the racketeering litigation, and the parties did not insist that he do so.[33] Nonetheless, as the special master recognized, the deposition "prove[d] . . . that it is imperative for lawyers to insist that clients disclose who the investors are."[34]

Because judges do not learn of TPLF in their cases via Rule 7.1 or most local rules, they are unlikely to become aware of conflicts generated by it unless courts make their own inquiries. But many judges do not even think to ask; as a judicial member of the Committee has observed, "[a] number of my colleagues are not even aware that it happens."[35] A judge who considers it an obligation to determine whether financial entitlements tied directly to the outcome of a case might pose a conflict of interest will likely appreciate a Rule 16(c)(2) prompt to make an appropriate inquiry and start doing so in his or her cases.

b. A Rule 16(c)(2) Prompt About TPLF Would Help Judges Identify Who May Be Needed During Settlement Conferences.

Rule 16 authorizes judges "to direct that, in appropriate cases, a responsible representative of the parties be present or available by telephone during a conference in order to discuss possible settlement of the case."[36] The 1993 Committee Notes clarify that courts have discretion to include non-parties as well: "Whether this would be the individual party, an officer of a corporate party, a representative from an insurance carrier, or someone else would depend on the circumstances."[37] The Committee Notes further explain that "[t]he explicit authorization in the rule to require personal participation in the manner stated is not intended to limit the reasonable exercise of the court's inherent powers," or "its power to require party participation under the Civil Justice Reform Act of 1990," quoting 28 U.S.C. § 473(b)(5) for the proposition that "civil justice expense and delay reduction plans adopted by district courts may include [a] requirement that representatives 'with authority to bind [parties] in settlement discussions' be available during settlement conferences."[38] Courts have recognized the power to require decision makers to be available at pre-trial conferences.[39] As the Committee knows,[40] there are compelling examples of litigation funders being vested with authority to influence or control litigation decisions, including with regard to settlement. Specifically:

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[30] *Id.*
[31] *Id.*
[32] *Id.*
[33] *Id.*
[34] *Id.* (citation omitted).
[35] Advisory Committee on Civil Rules, Agenda Book, at 76 (Apr. 2-3, 2019).
[36] Fed. R. Civ. P. 16 advisory committee notes to 1993 amendment.
[37] *Id.*
[38] *Id.*
[39] *See, e.g.*, *In re Stone*, 986 F.2d 898, 903 (5th Cir. 1993) ("[S]ubject to the abuse-of-discretion standard, district courts have the general inherent power to require a party to have a representative with full settlement authority present—or at least reasonably and promptly accessible—at pretrial conferences.").
[40] *See* Rule Suggestion 19-CV-I, https://www.uscourts.gov/sites/default/files/19-cv-i-suggestion_advanced_medical_et_al_0.pdf.

- In *Boling v. Prospect Funding Holdings, LLC*,[41] the U.S. Court of Appeals for the Sixth Circuit concluded that the terms of the funding agreements involved in that matter "effectively give [the non-party investor] substantial control over the litigation," including terms that "may interfere with or discourage settlement" and otherwise "raise quite reasonable concerns about whether a plaintiff can truly operate independently in litigation."

- In *White Lilly, LLC v. Balestriere PLLC*,[42] a non-party investor with a financial interest in a lawsuit asserted that it had the right to exercise control over the litigation. In its complaint, the non-party investor alleged that it had a contractual right to assign a particular lawyer to serve as one of the plaintiff's counsel in the lawsuit and alleged that its counsel breached her obligation to serve as its "ombudsman" to oversee the cases it had invested in. The funding agreement required that "[d]efendants obtain prior approval for expenses in excess of $5,000.00."[43]

- A 2017 "best practices" guide by IMF Bentham (now Omni Bridgeway) for non-party financial interests in litigation highlights the importance of giving the investor the authority to: "'[r]eceive notice of and provide input on any settlement demand and/or offer, and any response'; and participate in settlement decisions."[44]

- In the putative class action *Gbarabe v. Chevron Corp.*,[45] the funding agreement required that counsel "give reasonable notice of and permit [the non-party investor] where reasonably practicable, to . . . send an observer to any mediation or hearing relating to the Claim."[46]

- And in the Chevron litigation discussed above, the funding agreement "provide[d] control to the Funders" through the "installment of 'Nominated Lawyers'"—lawyers "selected by the Claimants with the ***Funder's approval***.'"[47]

Including TPLF as a topic for discussion under Rule 16 would facilitate more accurate and realistic settlement negotiations between the parties. Further, it will allow courts to structure settlement protocols with greater potential to succeed. For example, if a litigation funder

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[41] 771 F. App'x 562, 579-80 (6th Cir. 2019).
[42] Compl. ¶ 35, No. 1:18-cv-12404-ALC, ECF No. 1 (S.D.N.Y. Dec. 31, 2018).
[43] *Id.* ¶ 124.
[44] John H. Beisner, Jessica Davidson Miller and Jordan M. Schwartz, *Selling More Lawsuits, Buying More Trouble: Third Party Litigation Funding A Decade Later*, U.S. Chamber Institute for Legal Reform (Jan. 2020), at 19, https://instituteforlegalreform.com/wp-content/uploads/2020/10/Still_Selling_Lawsuits_-_Third_Party_Litigation_Funding_A_Decade_Later.pdf (quoting Bentham IMF, *Code of Best Practices* (Jan. 2017)).
[45] No. 14-cv-00173-SI, 2016 U.S. Dist. LEXIS 103594, at *6 (N.D. Cal. Aug. 5, 2016).
[46] Litigation Funding Agreement § 10.2.4 (dated Mar. 29, 2016) (attached to Decl. of Caroline N. Mitchell in Supp. of Chevron Corp.'s Mem. in Opp'n to Mot. for Class Certification & Mots. to Exclude the Reports & Test. of Onyoma Research & Jasper Abowei as Ex. 13), *Gbarabe v. Chevron Corp.*, No. 3:14-cv-00173-SI, ECF No. 186 (N.D. Cal. Sept. 16, 2016).
[47] Maya Steinitz, *The Litigation Finance Contract*, 54 Wm. & Mary L. Rev. 455, 472 (2012) (emphasis added) (footnote omitted).

controls settlement decisions (in whole or in part), the court may wish to require that funder to attend any mediation. Absent disclosure, the funder's presence as a player in the settlement process likely will remain hidden.

c. A Rule 16(c)(2) Prompt About TPLF Would Improve Oversight Of Class Actions.

Rule 23 requires that the named plaintiff and class counsel "fairly and adequately protect the interests of the class."[48] Consistent with that principle, judges presiding over class action cases must also approve proposed class action settlement proposals, which includes reviewing the parties' "statement identifying any agreement made in connection with the [settlement] proposal."[49] According to the Committee Notes, such agreements "normally should be considered," because those agreements, "although seemingly separate, may have influenced the terms of the settlement by trading away possible advantages for the class in return for advantages for others."[50] TPLF agreements providing non-parties a direct right to proceeds from the litigation fit squarely within this obligation. Adding a Rule 16(c)(2) prompt would help inform the judge's duty to protect class members at other stages of the case as well, including while appointing class counsel, approving attorney's fees, and entertaining class member objections. These are precisely the reasons that led the Northern District of California to adopt a TPLF disclosure requirement for class actions:

> In any proposed class, collective, or representative action, the required disclosure includes any person or entity that is funding the prosecution of any claim or counterclaim.[51]

Notably, even non-party litigation investors concede the importance of this information to judges presiding over class actions. As one executive of a prominent TPLF funder put it, "the logic for disclosure is somewhat stronger [in class actions], given the court's independent obligation to monitor the protection of class members' interests."[52] Adding a prompt in Rule 16(c)(2) would apply what the Committee has already found to be important—consideration of non-party contractual interests in settlement proceeds at the settlement stage—to help judges consider an appropriate inquiry that would inform class protections from the outset of the case.

d. A Rule 16(c)(2) TPLF Prompt Would Help Inform Judges' Decisions Relating To The Scope Of Discovery, Protective Orders, And Sanctions.

Rule 26(b)(1) defines the scope of discovery to include consideration of "the parties' resources."[53] A judge who is ruling on a discovery scope question therefore might want to be aware of any TPLF in the case, which is plainly relevant to the parties' resources. For the same

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[48] Fed. R. Civ. P. 23(a)(4).

[49] Fed. R. Civ. P. 23(e)(2) and (3).

[50] Fed. R. Civ. P. 23(e)(2) advisory committee notes to 2003 and 2018 amendments.

[51] N.D. Cal. Standing Order § 19.

[52] Cayse Llorens, chief executive officer, and Matthew Oxman, vice president of business development and investments, LexShares Inc., *What Litigation Funding Disclosure In Delaware May Look Like*, Law360 (June 10, 2022), https://www.law360.com/articles/1501720/what-litigation-funding-disclosure-in-delaware-may-look-like ("Llorens & Oxman Article").

[53] Fed. R. Civ. P. 26(b)(1).

reasons, a judge fashioning a protective order—particularly one that allocates expenses pursuant to Rule 26(c)(1)(B)—might want to consider inquiring if non-parties hold direct stakes in any proceeds from the case. Similarly, a court may want to know if the case is being funded pursuant to TPLF when contemplating an appropriate sanction under Rule 37. Because TPLF arrangements can mean that an investor is effectively a real party in interest, a court might find that an investor should bear responsibility in the event there is wrongdoing and a corresponding imposition of sanctions or costs. In cases potentially involving any of these matters, judges would likely appreciate a prompt to make an appropriate inquiry regarding the existence of TPLF in the litigation.

III. Amending Rule 16 To Provide A Useful Prompt Would Be Simple.

Adding an effective prompt to Rule 16 would be simple. Where Rule 16(c)(2) lists "matters for consideration," adding a point along the following lines would suffice:

> 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.

Unlike the mandatory disclosure rule that the Committee has been considering, a Rule 16(c)(2) prompt does not require the Committee to wrestle with: the types of cases to which it applies; the types of litigation funding entities or arrangements governed by such a rule; whether a mandatory rule would negatively affect the litigation finance industry;[54] the sources of funding covered; what must be disclosed; to whom disclosure is made; or whether follow-on discovery is appropriate. A case-by-case approach, governed by individual judges' discretion, will allow for appropriate handling of these issues tailored to the circumstances of each case. Furthermore, a Rule 16(c)(2) approach would be in keeping with the view expressed by TPLF investors themselves that "we would recommend that courts treat disclosure on a case-by-case basis."[55]

Conclusion

The Committee should amend Rule 16(c)(2) to prompt judges to consider inquiring about prevalent but undisclosed non-party investments in their cases. Doing so would help judges better oversee their cases and promote more informed decisions while honoring their judicial discretion. It would also support the Judicial Conference's goal of promoting a greater "culture of compliance" in the judiciary because, without knowing whether a non-party holds a financial stake in the proceeds of a case that is directly affected by the outcome, judges may be unable to determine whether such an interest creates a conflict for themselves or others. Some judges will appreciate the reminder to identify the people who may be needed during a settlement conference. And some judges will value the prompt to learn facts potentially relevant to "the parties' resources," protective orders, and sanctions.

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[54] A Rule 16(c)(2) prompt would be even less onerous to the industry than Chief Judge Connolly's mandatory Standing Order, which "is unlikely to have onerous effects on litigation finance," according to one large litigation finance company. Llorens & Oxman Article. Burford does not list a disclosure requirement specifically as a risk to its business in its regulatory filings. *See* Burford 2021 Annual Report.

[55] Llorens & Oxman Article.

Testimony to the Senate Judiciary Committee
In Opposition to SB74

February 2, 2023

Chair Warren and Committee Members:

Burford Capital is the leading global finance and asset management firm focused on law. Burford is publicly traded on the New York Stock Exchange (NYSE:BUR) and the London Stock Exchange (LSE:BUR), and works with companies from startups to the Fortune 500 as well as law firms across the U.S. and around the world, including those traditionally viewed as "defense-side" firms.

Burford is engaged in the business of commercial legal finance, *i.e.*, the provision of capital to law firms and businesses represented by sophisticated counsel, typically in the form of multimillion-dollar non-recourse investments. Because the provider's return is dependent on a successful outcome and because these agreements do not constrain or interfere with the client's ability to resolve the underlying matter at any time or for any amount, providers will by definition fund only the most meritorious matters; if they do not, they will quickly go out of business. Capital from these arrangements may be used for fees or expenses associated with litigation—on either side of a pending claim, or to recover millions in otherwise lost value through judgment enforcement, or to budget in the face of economic or legal uncertainty. In essence, commercial legal finance is unremarkable, akin to the financing that a business obtains to collateralize assets like real estate or equipment.

As I previously testified to this Committee, the vast majority of courts and legislatures have declined to impose additional unnecessary regulation on the commercial legal finance industry, particularly because commercial legal finance does not present any novel ethical or evidentiary issues that cannot be addressed by the U.S. justice system's clear and robust discovery and professional conduct rules.

Commercial Legal Finance Arrangements are Privileged

Materials created for and provided to a potential finance provider as a consequence of litigation are protected under the work product doctrine in the U.S.[1] Accordingly, the vast majority of

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[1] Since finance providers do not control matters and provide capital on a non-recourse basis, they must carefully diligence a matter. Similarly, deal documents are protected because they were created due to the litigation, and the terms of such agreements reflect the information provided in work-product protected documents, such as lawyers' mental impressions, theories and strategies about the underlying litigation. For an overview of caselaw affirming work product protection for communications with legal finance providers, see "Work product protection for legal finance," available at: burfordcapital.com/blog/work-product-protection-for-legal-finance/.

courts do not require disclosure of legal finance arrangements in commercial matters.[2] And, as the Advisory Committee on Civil Rules of the U.S. Judicial Conference has repeatedly observed in rejecting proposals to change the Federal Rules of Civil Procedure to force disclosure of these agreements, if a judge were to determine that such an agreement was relevant to a proceeding, he or she currently has the authority to obtain the information necessary.[3]

Commercial Funders Do Not Control Litigation

At Burford, we enter into carefully negotiated, multimillion-dollar transactions with law firms and corporations represented by sophisticated counsel. Burford's agreements state that we neither control nor will we seek to control strategy, settlement or other litigation-related decision-making, nor direct a counter-party to settle a case at all, or for a particular amount. We will not withhold contractually required funding for strategic reasons. We are passive investors and we do not control the legal assets in which we invest. These decisions remain entirely with the client. In the U.S., the vast majority of commercial legal finance providers behave similarly.

Commercial Legal Finance Does Not Present a Conflict of Interest

Potential conflicts relating to legal finance agreements are no different than any other potential conflict. The assertion that legal finance may result in attorneys breaching their duties of loyalty and confidentiality to their clients is pure speculation, as no one has ever offered an example of this actually occurring. Nor has anyone offered any real-world examples of judicial conflicts of interest; they are acutely aware of their ethical responsibilities and would be well advised to avoid investing in legal finance entities. And even if a judge were to have a relationship that rose to the level of warranting disqualification, they can and do issue individual practice rules or standing orders requiring disclosure of any relationship with that company. While rules vary by jurisdiction, those that exist generally share the limited purpose of ensuring that adjudicators are not inadvertently deciding a matter in which they have a conflict. Any other concerns about conflicts or other ethical issues are more than adequately addressed by existing discovery and professional conduct rules.

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[2] *See Miller UK Ltd. v. Caterpillar, Inc.*, 17 F. Supp. 3d 711, 734-35 (N.D. Ill. 2014) ("For purposes of a privilege analysis, there is nothing unique about cases involving third party litigation funding. . . . Materials that contain counsel's theories and mental impressions . . . do not necessarily cease to be protected because they may also have been prepared or used to help [a client] obtain financing."); *see also Colibri Heart Valve LLC v. Medtronic CoreValve LLC, et. Al,* Case No. 8:20-cv-00847 (C.D. Cal. Mar. 26, 2021); *Impact Engine, Inc. v. Google LLC,* Case No. 3:19-cv-01301-CAB-DEB (S.D. Cal. Oct. 20, 2020); *Continental Circuits LLC v. Intel Corp.*, 435 F.Supp.3d 1014, 1020-21 (D. Ariz. 2020); *MLC Intellectual Prop. LLC v. Micron Tech., Inc.*, No. 14-cv-03657, 2019 WL 118595, at *2 (N.D. Cal. Jan. 7, 2019); *Lambeth Magnetic Structures, LLC v. Seagate Tech. (US) Holdings, Inc.,* No. CV 16-538, 2018 WL 466045; *VHT, Inc. v. Zillow Group, Inc.,* No. C15-1096JLR, 2016 WL 7077235, at *1 (W.D. Wash. Sept. 8, 2016).

[3] *See, e.g., In re Nat'l Prescription Opiate Litig.*, No. 1:17-MD-2804, 2018 WL 2127807, at *1 (N.D. Ohio May 7, 2018) (requiring disclosure to be made *ex parte* and *in camera* to the judge and stipulating that no discovery would be permitted).

Conclusion

If enacted, SB74 would lead to the exposure of information of legally privileged or sensitive information about how Kansas businesses do business. Litigation is not an excuse for one party to conduct a fishing expedition into another's finances, and overbroad disclosure requirements undermine the judicial goal of efficiency. Disclosure for disclosure's sake simply is not a legitimate basis for sound public policy. For the foregoing reasons, we strongly urge the Committee to oppose this legislation.

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Legal Opinion Letter

Vol. 33 No. 8 May 17, 2024

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

by Brett Clements and Elyse Shimada

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

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[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.

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[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).

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).

U.S. Judges Explain the Drawbacks of Forced Disclosure of Legal Finance

May 28th, 2024

Back to Blog

At ILFA's 2024 New York Conference in April, a panel of current and former federal judges criticized proposals to force disclosure of legal finance.

The panel featured the Hon. Robert M. Dow Jr., Counselor to Chief Justice John Roberts; the Hon. Ursula Ungaro, former Senior Judge of the U.S. District Court for the Southern District of Florida; and the Hon. Sam S. Sheldon, U.S. Magistrate for the Southern District of Texas.

The judges disputed the notion advanced by advocates of forced disclosure that it merely promotes transparency. Rather, they said such a mandate could hinder the confidentiality of litigation strategy for both sides. “Public disclosure of too much really gets into litigation strategy,” Judge Dow said. He added it is “really not fair to give one side the other side’s litigation strategy unless it’s mutual.” And since funders do not have control over litigation, he said it is unlikely that judges will be concerned about disclosing the source of that funding. “As long as the funder doesn’t have control, I don’t think it’s going to be a major issue for judge,” he said.

Judge Ungaro echoed the sentiment. “I’m still struggling with the idea that any of this should be disclosed,” she said. “There are all kinds of things that go on in the world that have some influences on lawyers and clients and judge’s cases, to think that disclosure is going to solve that problem is nonsense.”

Read more about ILFA’s 2024 New York Conference here.

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An Overview of How Third-Party Litigation Funders are Being Addressed by Courts and Policymakers

03 June 2024
Client Updates

In recent years, third party litigation funding (TPLF) for patent cases has been on the rise, and the subject of increased discussion and scrutiny. One recent article conservatively estimated that funders are fronting around $2.3 billion annually while another source put it at $5 billion.[1] This issue has caught the attention of judges, who are implementing new rules and sanctioning those who fail to comply. It has similarly caught the attention of policymakers, who are proposing and enacting legislation aimed at increasing transparency and addressing concerns about foreign involvement in United States legal proceedings.

Understanding Third-Party Litigation Funding

TPLF, often referred to as litigation finance, is a financial arrangement in which a third party in a legal dispute provides funding to support the plaintiff's pursuit of a legal claim. In return, the third-party funder receives a portion of the proceeds if the case is successful. This funding model allows entities to bring lawsuits without shouldering the financial risks associated with litigation.

The emergence of TPLF has been driven by various factors, including the escalating costs of legal proceedings, the complexity of modern litigation, and the desire to level the playing field between parties with disparate financial resources. Proponents argue that litigation funding enhances access to justice by enabling individuals and entities with valid claims to seek redress in court. For inexperienced or even just risk-averse patent rights holders, securing litigation financing may be the only feasible way to protect their intellectual property rights.

Concerns Surrounding Litigation Funding

Despite its perceived benefits, TPLF has elicited numerous concerns from the legal community and policymakers, who have raised the potential for conflicts of interest and weakening of attorney-client privilege. Critics further contend that external financiers might inappropriately influence case strategies, decisions on settlements, and other crucial elements of the legal process, thereby undermining the integrity of legal advocacy.

Criticism also focuses significantly on the role of litigation financiers in the patent arena, where they are believed to potentially increase baseless lawsuits brought by patent assertion entities or patent monetizers, often termed “patent trolls.” Some critics argue that engaging in litigation purely for financial gain contradicts the fundamental goal of patent protections, which is to foster innovation. When companies are forced to redirect resources to defend against such lawsuits, often backed by substantial Wall Street funding, it detracts from their core businesses and innovation efforts. Moreover, since litigation-funded parties face little personal risk, there can be incentive to initiate frivolous or unwarranted suits, prompting businesses to opt for out-of-court settlements to escape the high costs and uncertainties of protracted litigation.

Examples of Recent Orders and Cases That Disfavored Litigation Funders

Litigation financing is a legitimate and sometimes necessary mechanism for patent holders to gather the necessary resources to assert their intellectual property rights. However, the consequences facing parties and their counsel in recent cases serve as a cautionary reminder of the responsibility that attorneys owe to their clients and to the courts before which they appear. In recent years, TPLFs have been the subject of standing orders requiring disclosure of such arrangements and have faced judicial scrutiny and sanctions.

California

In the case of *Taction Tech., Inc. v. Apple Inc.*, the court determined that litigation-funding related documents could be directly relevant to the extent that the documents “contain or reflect valuations of the Asserted Patents”[2] However, to address the plaintiff’s concerns about privilege and work product, the court limited the discovery scope.[3] It restricted access to documents that contained or reflected valuations of the asserted patents, while excluding any documents that pertained to negotiations or viewpoints regarding actual or potential financial interests or ownership, as well as any agreements or communications related to actual or potential licenses or licensing strategies. The court also determined that some documents, including documents containing express confidentiality clauses about the litigation funding agreements and their terms, were prepared by or for Taction in anticipation of litigation, and therefore were protected work product. But the court did not deem the disclosure of the *identity* of the funders, litigation agreements, and documents related to patent valuation as protected under the work-product doctrine.[4] In sum, the court granted the motion concerning the disclosure of the identities of the litigation funders and the existence of the funding agreement, and denied the motion to compel the production of communications regarding TPLF or the actual TPLF agreements with the plaintiff or the inventor.

Delaware

Chief Judge Colm F. Connolly of the District of Delaware has particularly pushed for transparency, disclosure, and adherence to ethical standards in the context of TPLF.

In April 2022, Judge Connolly issued a standing order ordering parties 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 direct or indirect interest in the party has been identified.”[5] The order appears aimed to shed light on the network behind certain non-practicing entities (NPEs) that frequently file patent litigation cases.

single patent or patent family as the new LLC's only asset. Judge Connolly issued a series of orders to these plaintiffs to appear in person at a special hearing to address concerns that they were not disclosing all of their litigation funding and ownership information.[9] This is despite the fact that most all of the 14 cases had been voluntarily dismissed by the plaintiffs either before or shortly after the judge requested the in-person hearing, or had notices in the docket stating that a settlement had been reached before the judge set the hearing. The hearing took place on November 4, 2022, and Judge Connolly then ordered the plaintiffs to produce documents to address his concerns about whether the named plaintiff(s) in the cases was the real party in interest.[10]

On March 31, 2023, Judge Connolly issued a six-page order giving the plaintiff Backertop 30 days to submit more information about its business and ownership, raising concerns that the parties may have 'perpetrated a fraud on the court."[11] On April 21, 2023, Backertop voluntarily dismissed the case.[12] The judge still ordered Lori LaPray, the sole owner and managing partner of Backertop Licensing LLC, and her brother Jacob LaPray, the sole owner and managing partner of Creekview IP LLC, to appear in court in Wilmington, but both refused. Judge Connolly then issued a $200 per day fine against Lori LaPray.[13]

In another case, *Nimitz Tech. LLC v. CNET Media, Inc.*, after ordering the parties to certify compliance with his April 2022 Standing Order, Judge Connolly issued another order that Nimitz shall show cause for why it should not be held in contempt for failing to comply.[14] Judge Connolly stayed the case until a November 30, 2022 hearing on this point.[15] Judge Connolly then issued an order requiring Nimitz to disclose information related to third-party interests, including engagement letters, assets and bank account information, and correspondence between its attorneys, Mavexar, and IP Edge.[16] Nimitz appealed, asking the Federal Circuit to reverse Judge Connolly's order and "terminate [the court's] judicial inquisition of the Petitioner."[17] The Federal Circuit denied Nimitz's petition to vacate the order and stated that "a direct challenge to [Chief Judge Connolly's] standing orders at this juncture would be premature" and that Nimitz did not show "that mandamus is its only recourse to protect privileged materials."[18]

Illinois

In the case of *Gamon Plus, Inc. v. Campbell Soup Co.*, the defendants sought discovery concerning any third party's financial interest in this action, including relevant litigation funding or contingency fee agreements.[19] The plaintiffs declined to provide these documents and suggested that the court perform an *in camera* review to verify their relevance and to determine whether these communications were protected by the work product doctrine.[20] The defendants contended that this information was crucial for establishing the plaintiffs' standing and, more critically, for determining the value of the patents, noting the absence of any licenses related to these patents granted to third parties and an apparent lack of established licensing practices by the plaintiffs.[21] However, the court decided against conducting an *in camera* review and instead instructed plaintiffs to comply with the document production request and, if necessary, produce a privilege log to allow defendants to assess the claims.

Recent Cases That Favored Litigation Funders

Texas

However, not every court is tightening regulations on litigation financing; Texas federal courts, in fact, are doing the contrary. "Precedent in the Western District of Texas has consistently denied motions to compel production of information related to litigation funding."[22] The Eastern District of Texas has similarly actively forbidden parties from requesting funding information. Both the Eastern and Western Districts of Texas remain the hotspots for NPE activity. In 2023, the Eastern District was home to the most NPE filings in the country, with the Western District of Texas only 54 cases behind. Together, the Eastern and Western Districts saw nearly 1,000 cases filed by NPEs.[23]

In the case of *Mullen Indus. LLC v. Apple Inc.*, Mullen declined to provide any discovery (either documents or testimony) regarding its funders and investors. [24] Apple contended that (i) funders and investors could be vital witnesses regarding damages at trial and (ii) if any of Mullen's investors or funders were based in California, it would bolster Apple's argument for transferring the case to California.[25] Additionally, Apple suggested that discussions between Mullen and third parties about price of investing, which would likely not be protected by privilege, might reveal admissions regarding the inferior quality of Mullen's patents and their presumed "nuisance" value.[26] Mullen countered that any litigation funders or investors were not relevant to Apple's ongoing transfer motion, and that any compelled disclosure would breach attorney-client privilege, work product doctrine, or other relevant legal protections.[27] The court granted Mullen's request for relief from the defendant's discovery demands without stating a reason, and quashed the related deposition notices regarding the identities of the plaintiff's litigation funders and investors.[28]

In the case of *Trustees of Purdue Univ. v. STMicroelectronics N.V.*, Defendants moved to compel conversations with a litigation funder, but the court reviewed these documents *in camera* and then denied the motion, finding the documents irrelevant and privileged.[29] *As to privilege,* the court described the litigation funder as "an entity offering significant legal services that go beyond merely litigation funding."[30]

In the case of *Lower48 IP LLC v. Shopify, Inc.*, Shopify requested the court issue an order compelling Lower48 to disclose all third-party interests involved in the action, alleging that IP Edge and USIF were both providing financial support.[31] Judge Ezra adopted Magistrate Judge Gilliland's order that recommended denial of defendant's motion, which noted, "none of the judges of the Western District of Texas have ordered the production of [disclosure of all third-parties]."[32]

In the case of *Fleet Connect Sols. LLC v. Waste Connections US, Inc.*, Waste Connections requested that Fleet Connect disclose litigation funding agreements, arguing these litigation funding agreements, if any exist, would show whether plaintiff negotiated away any ownership rights to the patents, which is relevant to whether plaintiff can meet its burden to show standing.[33] Waste Connections further argued that the terms within these funding agreements were crucial for assessing expert bias, witness motivations, and a realistic appraisal of the case. [34] However, the court denied Waste Connections' Motion to Compel, finding that Waste Connections failed to show that litigation funding agreements are relevant to its claims or defenses. And by demanding these documents "under the guise of determining ownership", Waste Connections was engaging in a fishing expedition aimed solely at shifting the burden of proof for standing to Fleet Connect before Waste Connections had legitimately challenged standing.[35]

Illinois

In the case of *Kove IO, Inc. v. Amazon Web Services, Inc.*, AWS issued a Rule 30(b)(6) notice with at least three topics referencing litigation funding.[36] Kove then sought a protective order to prevent discovery related to litigation funding, including document requests, interrogatories, and questioning of witnesses.[37] AWS argued that this information was relevant because "in patent litigation, where a plaintiff seeks to establish damages based on a reasonable royalty, litigation funding information helps show what a 'hypothetical necessary to rebut Kove's anticipated portrayal of a David-and-Goliath narrative at trial.[42] But the court found that attempting to challenge a narrative, as opposed to substantiating a legal argument, did not meet the criteria for discovery under the Federal Rules of Civil Procedure. Finding the materials regarding litigation funding negotiations at best minimally relevant, the court granted the plaintiff's motion for a protective order.

The cases outlined above indicate a divide among district courts regarding whether documents associated with third-party litigation financing are relevant for confirming standing, appraising the value of the patents in question, and understanding the plaintiff's financial capabilities in patent litigation contexts. Parties should anticipate that they may need to reveal at least the identity of their financier or the presence of a litigation funding agreement. And, depending on the venue, TPLF-related documents might be obtainable in discovery.

Judicial and Policy Responses

In response to the growing prominence of TPLF, judges and policymakers have begun addressing the associated challenges and risks. Courts have started to demand greater transparency regarding funding arrangements, requiring litigants to disclose the identities of third-party funders and the nature of the funding agreements.

For example, the following federal courts have disclosure requirements that might affect TPLF, with these rules differing in terms of the cases to which the rules apply, the scope of information to be provided, the reasons for disclosure, as well as when and how this information must be disclosed:

- N.D. of California (Northern District of California, Standing Order for All Judges, Updated Nov. 30, 2023, available at https://cand.uscourts.gov/wp-content/uploads/2023/03/Standing_Order_All_Judges-11-30-2023.pdf) (emphasis added in bold):

  17. Disclosure of Non-party Interested Entities or Persons: Whether each party has filed the "Certification of Interested Entities or Persons" required by Civil Local Rule 3-15. **In addition, each party must restate in the case management statement the contents of its certification by identifying any persons, firms, partnerships, corporations (including parent corporations) or other entities known by the party to have either: (i) a financial interest in the subject matter in controversy or in a party to the proceeding**; or (ii) any other kind of interest that could be substantially affected by the outcome of the proceeding. **In any proposed class, collective, or representative action, the required disclosure includes any person or entity that is funding the prosecution of any claim or counterclaim**.

- Delaware (District of Delaware, Standing Order Re: Third Party Litigation Funding Arrangements, April 18, 2022, available at https://www.ded.uscourts.gov/sites/ded/files/Standing%20Order%20Regarding%20Disclosure%20Statements.pdf) (emphasis added in bold):

  STANDING ORDER REGARDING DISCLOSURE STATEMENTS REQUIRED BY FEDERAL RULE OF CIVIL PROCEDURE 7.1

  At Wilmington on this Eighteenth day of April in 2022, it is HEREBY ORDERED in all cases assigned to Judge Connolly where a party is a nongovernmental joint venture, limited liability corporation, partnership, or limited liability partnership, **that the party must include in its disclosure statement filed pursuant to Federal Rule of Civil Procedure 7.1 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**.
- New Jersey (District of New Jersey, Civ. L.R. 7.1.1, available at https://www.njd.uscourts.gov/sites/njd/files/CompleteLocalRules.pdf) (emphasis added in bold):

  > Civ. RULE 7.1.1 **DISCLOSURE OF THIRD-PARTY LITIGATION FUNDING**
  >
  > (a) Within 30 days of filing an initial pleading or transfer of the matter to this district, including the removal of a state action, or promptly after learning of the information to be disclosed, all parties, including intervening parties, **shall file a statement (separate from any pleading) containing the following information regarding any person or entity that is not a party and is providing funding for some or all of the attorneys' fees and expenses for the litigation on a non-recourse basis in exchange for (1) a contingent financial interest based upon the results of the litigation or (2) a non-monetary result that is not in the nature of a personal or bank loan, or insurance**:
  > 1. **The identity of the funder(s)**, including the name, address, and if a legal entity, its place of formation;
  > 2. **Whether the funder's approval is necessary for litigation decisions or settlement decisions in the action** and if the answer is in the affirmative, the nature of the terms and conditions relating to that approval; and
  > 3. **A brief description of the nature of the financial interest**.
  > (b) The parties may seek additional 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 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.
  > (c) Nothing herein precludes the Court from ordering such other relief as may be appropriate.
  > (d) This Rule shall take effect immediately and apply to all pending cases upon its effective date, with the filing mandated in Paragraph 1 to be made within 45 days of the effective date of this Rule. Adopted June 21, 2021.

Additionally, the following is an exemplary list of proposed or passed legislation relating to TPLF:

- US Congress: *Protecting Our Courts from Foreign Manipulation Act of 2023* (pending).
- Arizona: HB 2638, *The Litigation Investment Safeguards and Transparency Act* (pending)[43]

One key area for improvement involves the establishment of uniform standards and best practices for third-party funders, harmonizing regulations across jurisdictions to foster consistency and coherence in the treatment of TPLF. For instance, last year, more than 30 organizations penned a letter to the Committee on Rules of Practice and Procedure, advocating for adjustments to the Federal Rules of Civil Procedure to mandate the disclosure of TPLF.[50]

Conclusion

The rise of TPLF has sparked various concerns within the legal community and among policymakers. Companies, attorneys, and courts are learning how to navigate the complexities raised by litigation funding while upholding the principles of justice, fairness, and ethical conduct in our legal system.

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[1] Mark Popolizio, Third-party litigation funding in 2022 – three issues for your radar, Verisk, Jan. 31, 2022 (citing Considerations from the ABA's Best Practices for Litigation Funding, The National Law Review, Volume XI, Number 151 (Feb. 16, 2021); David H. Levitt & Francis H. Brown III, Third Party Litigation Funding: Civil Justice and the Need for Transparency, DRI Center for Law and Public Policy (2018), at 1)).
[2] *Taction Tech., Inc. v. Apple Inc.*, No. 21-CV-00812-TWR-JLB, 2022 WL 18781396, at *5 (S.D. Cal. Mar. 16, 2022)
[3] *Id.*
[4] *Id.* at *6-7.
[5] District of Delaware, Standing Order Re: Third Party Litigation

Funding Arrangements, April 18, 2022 (available at https://www.ded.uscourts.gov/sites/ded/files/Standing%20Order%20Regarding%20Disclosure%20Statements.pdf).
[6] *VLSI Tech. LLC v. Intel Corp.*, C.A. No. 18-966-CFC-CJB, 2022 WL 3134427 (D. Del. Aug. 1, 2022).
[7] *Longbeam Technologies LLC. v. Amazon.com, Inc.*, Case No. 1:21-cv-01559, Oral Order, (D. Del. Aug. 17, 2022).
[8] https://insight.rpxcorp.com/entity/1034412-ip-edge-llc
[9] *Mellaconic IP LLC v. TimeClock Plus, LLC.*, Case No. 1:22-cv-00244, Dkt. 10 (D. Del. Sept. 12, 2022); *Lamplight Licensing LLC v. ABB Inc.*, Case No. 1:22-cv-00418, Dkt. 9 (D. Del. Sept. 12, 2022); *Creekview IP LLC v. Jabra Corporation*, Case No. 1:22-cv-00426, Dkt. 19 (D. Del. Sept. 12, 2022); *Mellaconic IP LLC v. Deputy, Inc.*, Case No. 1:22-cv-00541, Dkt. 10 (D. Del. Sept. 12, 2022); *Backertop Licensing LLC v. Canary Connect, Inc.*, Case No. 1:22-cv-00572 (D. Del. Sept. 12, 2022); *Missed Call, LLC v. Freshworks, Inc.*, Case No. 1:22-cv-00739 (D. Del. Sept. 12, 2022).
[10] *See, e.g., Mellaconic IP LLC v. TimeClock Plus, LLC.*, Case No. 1:22-cv-00244, Dkt. 22 (D. Del. Nov. 10, 2022).
[11] *Backertop Licensing LLC v. Canary Connect, Inc.*, Civ. No. 22-572-CFC, 2023 WL 2734323 (D. Del. Mar. 31, 2023)
[12] *Backertop Licensing LLC v. Canary Connect, Inc.*, Case No. 1:22-cv-00572, Dkt. 28 (D. Del. April 21, 2023).
[13] *Backertop Licensing LLC v. Canary Connect, Inc.*, Case No. 1:22-cv-00572, Mem. Order, Dkt. 62 (D. Del. Oct. 3, 2023).
[14] *Nimitz Tech. LLC v. CNET Media, Inc.*, No. 21-1247-CFC, Order, Dkt. 20 (D. Del. May 23, 2022) (Connolly, J).
[15] *Nimitz Tech. LLC v. CNET Media, Inc.*, No. 21-1247-CFC, Order, Dkt. 25 (D. Del. Sept. 28, 2022) (Connolly, J).
[16] *Nimitz Tech. LLC v. CNET Media, Inc.*, No. 21-1247-CFC, Mem. Order, Dkt. 27 (D. Del. Nov. 10, 2022) (Connolly, J).
[17] *In re Nimitz Technologies LLC*, No. 2023-103, at 2 (Fed. Cir. Nov. 17, 2022) (on petition for writ of mandamus to the United States District Court for the District of Delaware in Nos. 1:21-cv-01247-CFC, 1:21-cv-01362-CFC, 1:21-cv-01855-CFC, and 1:22-cv-00413-CFC).
[18] *Id.* at 5.
[19] *Gamon Plus, Inc. v. Campbell Soup Co.*, No. 1:15-cv-08940, 2022 WL 18284320, at *2 (N.D. Ill. May 26, 2022)
[20] *Id.*.
[21] *Id.*.
[22] *Lower48 IP LLC v. Shopify, Inc.*, Case No. 6:22-cv-00997-DAE, Dkt. 36 (W.D. Tex. Nov. 2, 2023) (citing *Trustees of Purdue Univ. v. STMicroelectronics N.V.*, No. 6:21-cv-00727-ADA, Dkt. 250 (W.D. Tex. Jan. 18, 2023); *Mullen Indus. LLC v. Apple Inc.*, No. 6:22-cv-00145-ADA, Dkt. 64 at p. 5 (W.D. Tex. Oct. 19, 2022)).
[23] https://www.unifiedpatents.com/insights/2024/1/8/patent-dispute-report-2023-in-review
[24] *Mullen Indus. LLC v. Apple Inc.*, No. 6:22-cv-00145, Dkt. 64 (W.D. Tex. Oct. 19, 2022).
[25] *Id.*at 1-3.
[26] *Id.* at 2.
[27] *Id.* at 3-5.
[28] *Id.* at 8.
[29] *Trustees of Purdue Univ. v. STMicroelectronics N.V.*, No. 6:21-cv-00727-ADA, Dkt. 250 (W.D. Tex. Jan. 18, 2023)
[30] *Id.* at 6.
[31] *Lower48 IP LLC v. Shopify, Inc.*, Case No. 6:22-cv-00997, Dkt. 36, at 2 (W.D. Tex. Nov. 2, 2023).
[32] *Id.* at 3.
[33] *Fleet Connect Sols. LLC v. Waste Connections US, Inc.*, No. 2:21-cv-00365-JRG, 2022 WL 2805132, at *2 (E.D. Tex. June 29, 2022)
[34] *Id.* at *2.
[35] *Id.* at *3.
[36] *Kove IO, Inc. v. Amazon Web Servs., Inc.*, No. 18-cv-8175, Dkt. 497, at 19 (N.D. Ill. Jan. 25, 2022).
[37] *Id.*
[38] *Id.* at 20.
[39] *Id.*
[40] *Id.* at 21 (internal quotations omitted).
[41] *Id.*
[42] *Id.*
[43] https://legiscan.com/AZ/text/HB2638/id/2884987
[44] https://legiscan.com/CA/text/SB581/2023
[45] https://www.flsenate.gov/Session/Bill/2024/1276
[46] https://iga.in.gov/legislative/2024/bills/house/1160/actions
[47] https://legiscan.com/MT/bill/SB269/2023
[48] https://legiscan.com/RI/bill/S0632/2023
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[50] https://instituteforlegalreform.com/wp-content/uploads/2023/05/Coalition.Comments_ThirdPartyLitigationFunding77.pdf

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Litigation Funding and Confidentiality: A Comprehensive Analysis of Current Case Law

AUGUST 2023

WESTFLEET
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Litigation Funding and Confidentiality: A Comprehensive Analysis of Current Case Law

Revised August 2023

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† The authors gratefully acknowledge the assistance of Dai Wai Chin Feman, Managing Director - Commercial Litigation and Corporate Counsel of Parabellum Capital LLC, for his invaluable assistance in identifying relevant decisions and statutes important to our analysis.

I. INTRODUCTION

As the use of litigation funding has increased, especially in commercial disputes, the single legal issue that causes the most concern among lawyers for clients contemplating using funding is the availability, extent, and reliability of confidentiality afforded the communications necessary with funders. Indeed, this same concern is also very prominent in the minds of lawyers and parties facing parties they believe may be the beneficiaries of litigation funding.

Despite this obvious concern, prior to the publication of the first version of this article in 2018, no one had systematically reviewed all the publicly-available decisions on the subject of confidentiality of information and documents about litigation funding and attempted to draw reasoned conclusions. Until fairly recently, the number of these decisions has been small, but these decisions now appear to number 108. By the time we began the research for this article, these decisions comprised a sufficient body of law to permit a thorough analysis that now allows lawyers – whether representing clients contemplating using funding or clients opposing apparently funded parties – to provide their clients more informed advice and to guide their own actions either in protecting their clients' confidential information or considering attempts to obtain confidential information from opponents. That is the purpose of this article.[1,2]

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[1] Although this article focuses primarily on court decisions on discovery disputes, the disclosure of litigation funding has also arisen in other contexts, including in the adoption of local disclosure rules.

For instance, on June 21, 2021, the U.S. District Court for the District of New Jersey adopted an unprecedented, broad disclosure rule, which requires parties to disclose the identity of any third-party litigation funders; whether the funder's approval is necessary for litigation decisions, including settlement; and a brief description of the nature of the financial interest. *See* Order Amending Local Civil Rule 7.1.1 (June 21, 2021), https://www.njd.uscourts.gov/sites/njd/files/Order7.1.1%28signed%29.pdf. The New Jersey disclosure rule was used as a model by Chief Judge Colm F. Connolly of the District of Delaware. *See* Standing Order Regarding Disclosure Statements Required by Federal Rule of Civil Procedure 7.1 ("In all cases assigned to Judge Connolly where a party is a nongovernmental joint venture, limited liability corporation, partnership, or limited liability partnership, that party must include in its disclosure statement filed pursuant to Federal Rule of Civil Procedure 7.1 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."). The International Court of Arbitration to the International Chamber of Commerce ("ICC") adopted a similar rule when it updated its Rules of Arbitration in October 2020. Effective January 1, 2021, Article 11(7) requires parties to disclose the "existence and identity of any non-party which has entered into an arrangement for the funding of claims or defences and under which it has an economic interest in the outcome of the arbitration." *2021 Arbitration Rules*, ICC, https://iccwbo.org/dispute-resolution-services/arbitration/rules-of-arbitration/rules-of-arbitration-2021/#article_11 (last visited June 27, 2021). In January 2017, the Northern District of California updated its districtwide standing order to add language mandating third-party litigation financing disclosure; however, this order is limited to class actions, and not applicable to all civil proceedings. Jason D. Russell, Hillary A. Hamilton, and Matthew E. Delgado, *Third-Party Litigation Financing: Mandatory Disclosure on the Horizon?*, Skadden, Arps, Slate, Meagher & Flom,https://www.skadden.com/-/media/files/publications/2017/04/thirdpartylitigationfinancingmandatorydisclosureon.pdf (Apr. 19, 2017).

There has been debate about the applicability of general corporate disclosure rules to litigation funders. In nine U.S. courts of appeals and thirty district courts there are disclosure rules that arguably implicate litigation funding. These rules also also outside the scope of this article. Roy Strom, *Litigation Funders Risk Disclosure in Court Rules, GAO Moves*, Bloomberg Law, https://news.bloomberglaw.com/business-and-practice/litigation-funders-risk-disclosure-in-court-rules-gao-moves (Sept. 19, 2022, 9:57 AM). *See* Patrick A. Tighe, Survey of Federal and State Disclosure Rules Regarding Litigation Funding, Mem. to Advisory Committee on Civil Rules, https://bolch-test.law.duke.edu/wp-content/uploads/2018/04/Panel-5-Survey-of-Federal-and-State-Disclosure-Rules-Regarding-Litigation-Funding-Feb.-2018.pdf (Apr. 10, 2018) (providing more in-depth discussion of the status of court-rule based disclosure regimes).

In an unusual recent ruling in the context of the proposed settlement of a mass tort claims that is also outside the scope of this article, one court has recently ordered the disclosure in that case of litigation funding with the stated intent being the protection of claimants. *See* Case

Negotiating and obtaining commercial litigation financing for a case requires that a funder and a client discuss confidential information about the case.[3] Before a litigation funder invests in the case, the prospective funder signs a non-disclosure agreement and then conducts due diligence, evaluating the value of the case based on documents and analysis provided by the client, who we will refer to as the plaintiff[4] for simplicity. If the funder decides to invest in the case after seeing its strengths and weaknesses, the funder and plaintiff will consummate a funding agreement. Like the due diligence documents shared with prospective funders, the funding agreement probably includes sensitive information related to litigation strategy, such as the maximum amount of funding offered for the case or attorneys' opinions. Upon financing the plaintiff, the funder will probably continue to communicate with the plaintiff about the budget, strategy, and developments in the case. Naturally, the plaintiff and the funder will want to keep all these communications confidential and protected from discovery during litigation.

If the defendant believes the plaintiff sought or obtained funding, then he may seek to obtain discovery of two kinds of documents discussed above: the funding agreement and "non-deal documents." We include within "non-deal

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Management Order No. 61, 3, *In re 3M Combat Arms Earplugs Prod. Liability Litig.*, No. 3:19-md-02885 (N.D. Fla. Aug. 29, 2023).

[2] In Illinois, Missouri, Montana, West Virginia, and Wisconsin, state laws have been enacted that could potentially affect the disclosure of commercial litigation funding. *See* 815 Ill. Comp. Stat. Ann. 121/1 – 121/999; Mo. Ann. Stat. §§ 436.550 – 436.572 (West); 2023 Mt. Laws Ch. 360 (S.B. 269) (effective Jan. 1. 2024); Wis. Stat. Ann. § 804.01 (West); W. Va. Code Ann. §§ 46a-6N-1 - 46a-6N-5 (West). A detailed analysis of these laws is beyond the scope of this article.

[3] An attorney has a duty to protect a client's confidential information unless the client gives *informed* consent. *See* ABA Model Rules of Prof'l Conduct R. 1.6. The State Bar of California Standing Committee on Professional Responsibility and Conduct has issued a formal opinion that addresses the ethical obligations that arise when a lawyer represents a client whose case is being funded by a third-party litigation funder. *See* Cal. Bar Ass'n Comm. On Prof'l Resp. & Conduct, Op. 2020-204 (2020). The opinion states that as a part of an attorney's duty to protect a client's confidential information, he or she must warn the client of potential risks in sharing confidential information with litigation funders, such as the risk that the client's opposition may seek to compel communications between the funder and the client or lawyer and that a court may hold that the sharing effected a waiver of otherwise available evidentiary privileges. *Id.*

[4] The client is often a plaintiff in an already-filed suit, but could also be a party contemplating filing a lawsuit or a defendant in a suit. We believe our research and analysis in this article would generally apply regardless of whether the client receiving funding is a claimant who has not yet filed suit, a plaintiff in a pending suit, or a defendant facing a claim in litigation. Nevertheless, these issues most frequently arise in a context where the funded party is or becomes a plaintiff in litigation.

documents" all communications besides the contract to provide funding. This might include due diligence materials shared with the funder before the plaintiff and funder agree on funding, communications reflecting negotiations between funder and client over funding terms, and communications after agreement is reached, such as discussions with the funder about mundane administrative matters, litigation strategy, and budgeting. Once the defendant seeks discovery of the funding agreement and non-deal documents, the court either denies the defendant's request, compels the plaintiff to produce all the requested discovery, or compels production of only some of the requested information, excluding privileged or work-product material or material it concludes are not within the scope of permissible discovery. The court may analyze separately the scope of permissible discovery, as well as work-product and privilege issues, for the funding agreement and non-deal documents.

Prior to the publication of the first version of this article, many commentators apparently believe that lawyers were unable to predict whether a court would compel discovery of information shared with a commercial litigation funder because few decisions existed on the issue.[5] This article was written largely to dispel that myth. As of today, even though no appellate court has ruled precisely on when and under what circumstances litigation funding is discoverable[6], enough case law exists to see the shape and trend of the law on these questions. After analyzing 106 trial court decisions, we found courts most often deny or limit discovery of funding agreements and communications with funders, as shown by Figure 1. This trend has held true since the first version of

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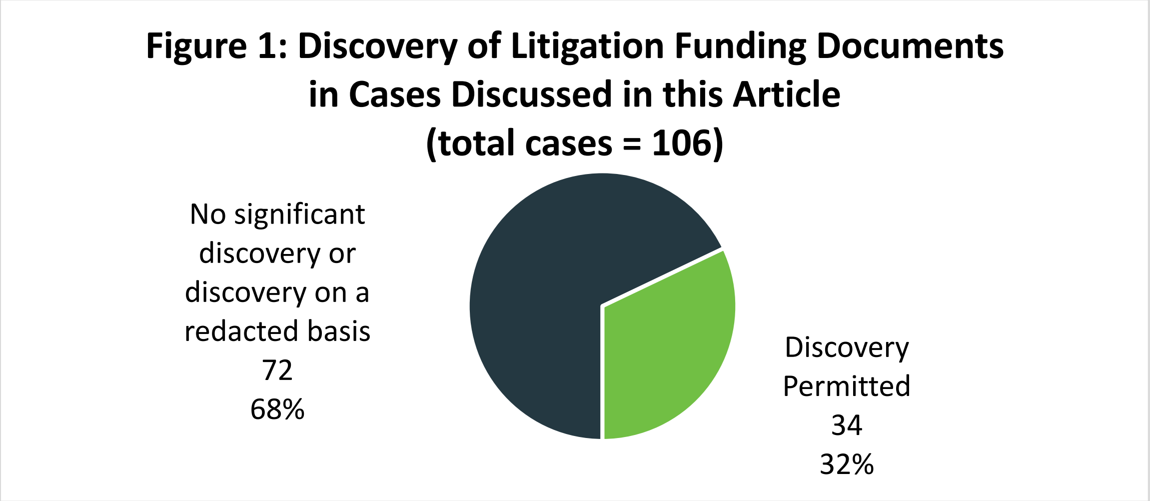
[5] *See, e.g.*, J. Maria Glover, *Alternative Litigation Finance and the Limits of the Work-Product Doctrine*, 12 N.Y.U. J.L. & Bus. 911, 926 (2016) (stating that it is premature to draw any broader conclusions about the trajectory of this case law because there are relatively few decided cases); Michele DeStefano, *Claim Funders and Commercial Claim Holders: A Common Interest or a Problem?*, 63 DePaul L. Rev. 305, 375-76 (2014); Grace M. Giesel, *Alternative Litigation Finance and the Work-Product Doctrine*, 47 Wake Forest L. Rev. 1083, 1085 (2012). News coverage of these cases suggests an even less predictable landscape. *See* Jacob Gershman, *Lawsuit Funding, Long Hidden in the Shadows, Faces Calls for More Sunlight: Courts have continued to divide over whether to order disclosure*, Wall St. J., Mar. 21, 2018, available at https://www.wsj.com/articles/lawsuit-funding-long-hidden-in-the-shadows-faces-calls-for-more-sunlight-1521633600.

[6] In *In re Nimitz Techs. LLC*, No. 2023-103, 2022 WL 17494845 (Fed. Cir. Dec. 8, 2022), on petition for a writ of mandamus, the Federal Circuit found that a standing order in the District of Delaware requiring the disclosure of litigation funding was valid. Additionally, the Lousiana state court appellate division has allowed litigation funding documents to be introduced for purposes of impeachment. *Dantzler v. Delacerda*, No. CW 1108, 2020 La. App. LEXIS 19993 (La. App. 1 Cir. Dec. 30, 2020).

this article. Occasionally, courts have allowed discovery of funding documents, but these cases tend to be unusual and these make up a minority of decisions.

This paper summarizes the outcomes of the discovery decisions we found and then explores the reasoning behind these decisions. Section II summarizes the outcomes and the clear trend toward protecting funding documents from discovery. Section III discusses why relevance to a claim or defense, attorney-client privilege, and the work-product doctrine have protected information shared with funders in these cases. While a few courts have compelled discovery of information shared with funders, after analyzing a properly-raised work-product claim, only seven courts have concluded that sharing information with a funder under normal commercial funding conditions waives all work-product protection.[7] Section IV gives special attention to several leading cases where a judge allowed discovery. This section analyzes the instances in which courts have examined these cases, the manner in which they were assessed, and the reasons



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[7] The leading cases in this regard are *Acceleration Bay LLC v. Activision Blizzard, Inc.*, No. 16-453-RGA, 2018 WL 798731, 2018 U.S. Dist. LEXIS 21506, at *5 (D. Del. Feb. 9, 2018) and *Leader Techs., Inc. v. Facebook, Inc.*, 719 F. Supp. 2d 373, 376 (D. Del. 2010) (finding not clearly erroneous a magistrate's decision that the common interest doctrine did not apply, so the plaintiff waived attorney-client privilege and work-product protection). A recurring circumstance that has resulted in litigation funding being discovered over a work-product defense occurs in infringement patent suits when the financing documents are allowed to be discovered to determine the worth of the patents on issue. *See Broadband ITV, Inc. v. OpenTV Inc.*, No. 17-561922, 2019 WL 13170112 (Cal. Super. June 20, 2019); *Electrolysis Prevention Sols., LLC v. Daimler Truck North Am. LLC*, No. 3:21-171, 2023 WL 4750822 (W.D.N.C. July 24, 2023). Additionally, the district court in *Midwest Ath. & Sports All. LLC v. Ricoh USA, Inc.*, No. 2:19-cv-00514-JDW, 2020 U.S. Dist. LEXIS 169770 (E.D. Pa. Sept. 16, 2020) stated plaintiff's submissions did not permit it to make a determination on whether work-product protection applied to communications between a party and litigation funder, its discussion on the issue strongly indicated that it would reject plaintiff's assertion of the privilege.

why a majority of judges have found these cases unpersuasive. We also provide a forward-looking viewpoint on why courts are unlikely to follow these cases, compared to the majority of decisions that have rejected the discovery of funding documents.

II. SUMMARY OF DISCOVERY DECISIONS

After an extensive search of the federal dockets and major legal databases, we found 136 opinions and orders deciding whether to deny or allow discovery of information shared with litigation funders. We identified 106 of these cases as directly deciding this issue and divided those cases into three general categories. Category One consists of instances where no discovery was allowed.[8] There are sixty cases in this category. In Category Two, courts allowed discovery of the funding agreement or non-deal documents but limited the scope of the discovery by redacting work-product or by denying discovery of work-product. Category Two contains twelve cases. Category Three is made up of cases where the court granted the request for significant, unredacted discovery of the funding agreement and/or non-deal documents. There are thirty-four cases in Category Three.

This article aims to capture the big picture of discovery decisions on litigation funding documents. Of course, the highly fact-specific nature of discovery decisions necessarily makes it challenging to summarize and categorize them without oversimplifying outcomes. Still, we attempt to focus on whether litigation funding documents are protected from discovery based on (1) attorney-client privilege, (2) work-product protection, or (3) lack of relevance. However, some of the discovery disputes do not fit precisely into these three boxes. For this reason, some of the cases included in the summary are not included in the specific breakdown that follows. Specifically, eleven cases are excluded because the decisions hinged on procedural issues, the analysis only applied to class action representatives, there was some additional confounding factor that distinguished the case, [9] or the motion was decided without

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[8] Two cases where very limited discovery was allowed was included in Category One because such limited information was ordered to be disclosed.

[9] For example, *Hologram USA, Inc. v. Pulse Evolution Corp.*, No. 2:14-cv-00772-GMN-NJK, 2016 U.S. Dist. LEXIS 87323, at *4-5, 7 (D. Nev. July 5, 2016) (denying discovery due to a failure to timely object) and *Bray & Gillespie Mgmt. LLC v. Lexington Ins. Co.*, No. 6:07CV222-ORL-35KRS, 2008 WL 5054695 (M.D. Fla. Nov. 17, 2008) have been excluded. In *Bray*, an early case addressing this issue, the court rejected the plaintiff's blanket objection to discovery on procedural grounds, and the court held it would resolve the discovery objection on a question by question basis in the future. Furthermore, though this article focuses on the discoverability of litigation funding documents, there are some district court cases that discuss the admissibility of litigation funding

explaination.[10] Also, noted below, but excluded from this summary, a case involving a patent monetization consultant, whose situation differs somewhat from commercial litigation financing.[11]

Category One – No or Limited Discovery Allowed. First, in sixty cases, courts denied the defendant's request for discovery of information shared with funders. In nearly all of these cases, the court refused to compel any discovery of the funding agreement or other information shared with a litigation funder.[12] In one

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documents at trial. *See Eastern Profit Corp. Ltd. v. Strategic Vision U.S., LLC*, No. 18-CV-2185, 2020 WL 7490107, at *8 (S.D.N.Y. Dec. 18, 2020) (denying defendant's motion in limine to exclude any questions or testimony regarding the sources of the litigation funding for either side of the action); *Thomas v. Chambers*, No. 18-4373, 2019 U.S. Dist. LEXIS 215380, at *10 (E.D. La. Apr. 26, 2019) (permitting defendant to introduce evidence regarding a financial arrangement between the plaintiffs and two third-party litigation funding companies for impeachment purposes); *Williams v. IQS Ins. Risk Retention*, No. 18-2472, 2019 U.S. Dist. LEXIS 30217, at *10 (E.D. La. Feb. 25, 2019) (holding a third-party funding agreement was not relevant and thus not admissible); *Pinn, Inc. v. Apple Inc.*, 19-01895-DOC, ECF No. 459 (C.D. Cal. July 14, 2021) (excluding evidence or argument regarding litigation funding).

[10] *E.g.*, *United States v. McKesson Corp. et al.*, 1:12-cv-06440-NG-ST, ECF No. 135 (E.D.N.Y., Apr. 28, 2021) (denying defendant's motion to compel in one-line order, and ordering plaintiff to submit any funding agreement to the court for in camera inspection).

[11] *E.g.*, *Intellectual Ventures I LLC v. Altera Corp.*, No. 10-1065-LPS, ECF No. 415 (D. Del. Jul. 25, 2013).

[12] *Medtronic Sofamor Danek, Inc. v. Michelson*, No. 01-2373, 2003 U.S. Dist. LEXIS 25198 (W.D. Tenn. Nov. 6, 2003); *Rembrandt Techs., L.P. v. Harris Corp.*, No. 07C-09-059-JRS, 2009 WL 402332, at *7, 2009 Del. Super. LEXIS 46 (Del. Super. Ct. Feb. 12, 2009); *Mondis Tech., Ltd. v. LG Elecs., Inc.*, No. 2:07-CV-565-TJW-CE, 2011 WL 1714304 (E.D. Tex. May 4, 2011); *Devon It, Inc. v. IBM Corp.*, No. CIV.A. 10-2899, 2012 WL 4748160 (E.D. Pa. Sept. 27, 2012); *Cabrera v 1279 Morris LLC*, 2012 WL 5418611 (N.Y. Sup. Ct. 2013); *Walker Digital v. Google*, Civ. No. 11-309-SLR (D. Del. Feb. 12, 2013); *Doe v. Soc'y of Missionaries of Sacred Heart*, No. 11-CV-02518, 2014 WL 1715376 (N.D. Ill. May 1, 2014); *Miller UK Ltd. v. Caterpillar, Inc.*, 17 F. Supp. 3d 711 (N.D. Ill. 2014); *The Abi Jaoudi and Azar Trading Corp. v. CIGNA Worldwide Ins. Co.*, No. 2:91-cv-0785 (E.D. Pa. Jul. 17, 2014); *Kaplan v. S.A.C. Capital Advisors, L.P.*, No. 12-CV-9350 VM KNF, 2015 WL 5730101, at *5, 2015 U.S. Dist. LEXIS 135031, at *18 (S.D.N.Y. Sept. 10, 2015), aff'd, 141 F. Supp. 3d 246 (S.D.N.Y. 2015); *Mobile Telecomms. Techs. LLC v. Blackberry Corp.*, No. 3:12-cv-01652 (N.D. Texas Nov. 2, 2015); *Yousefi v. Delta Elec. Motors, Inc.*, 2015 WL 11217257, 2015 U.S. Dist. LEXIS 180844 (W.D. Wash. May 11, 2015); *Ashghari-Kamrani v. United Services Automobile Assn.*, No. 2:15-CV-478, 2016 WL 11642670, at *14-15 (E.D. Va. May 31, 2016); *Harper v. Everson*, No. 3:15-CV-00575-JHM, 2016 U.S. Dist. LEXIS 197894 (W.D. Ky. June 27, 2016); *Hologram USA, Inc. v. Pulse Evolution Corp.*, No. 2:14-cv-00772-GMN-NJK, 2016 U.S. Dist. LEXIS 87323, at *4-5, 7 (D. Nev. July 5, 2016); *IOENGINE LLC v. Interactive Media Corp.*, No. 1:14-cv-01571 (D. Del. Aug. 3, 2016); *Telesocial Inc. v. Orange S.A.*, No. 3:14-cv-03985 (N.D. Cal. Sept. 30, 2016); *United States ex rel. Fisher v. Homeward Residential, Inc.*, No. 4:12-CV-461, 2016 U.S. Dist. LEXIS 32910, 2016 WL 1031154, (E.D. Tex. Mar. 15, 2016); *United States v. Ocwen Loan Servicing, LLC*, No. 4:12-CV-543, 2016 WL 1031157, 2016 U.S. Dist. LEXIS

32967 (E.D. Tex. Mar. 15, 2016); *VHT, Inc. v. Zillow Group, Inc.*, No. C15-1096JLR, 2016 WL 7077235, 2016 U.S. Dist. LEXIS 172373 (W.D Wash. Sept. 8, 2016); *Mackenzie Architects, P.C. v. VLG Real Estate Developers, LLC, et al.*, No. 1:15-CV-01105-TJM-DJS, 2017 WL 4898743 (N.D.N.Y. Mar. 3, 2017); *Viamedia, Inc. v. Comcast Corp.*, No. 16-CV-5486, 2017 WL 2834535, 2017 U.S. Dist. LEXIS 101852 (N.D. Ill. June 30, 2017); *In re: Nat'l Prescription Opiate Litig.*, No. 1:17-MD-2804, 2018 WL 2127807 (N.D. Ohio May 7, 2018); *Lambeth Magnetic Structures, LLC v. Seagate Tech. (US) Holdings, Inc.*, No. CV 16-538, 2018 WL 466045 (W.D. Pa. Jan. 18, 2018); *Space Data Corp. v. Google, LLC*, No. 16-CV-02360, 2018 WL 3054797 (N.D. Cal. June 11, 2018); *Benitez v. Lopez*, 2019 U.S. Dist. LEXIS 64532, 2019 WL 1578167 (E.D.N.Y. Mar. 14, 2019); *Dupont v. Costco Wholesale Corp.*, No. 17-04469, 2019 WL 8158471 (E.D. La. Oct. 15, 2019), *aff'd*, No. CV 17-4469, 2019 WL 5959564 (E.D. La. Nov. 13, 2019); *Hybrid Ath., LLC v. Hylete*, No. 3:17-cv-1767 (VAB), 2019 U.S. Dist. LEXIS 148245, at *37-38 (D. Conn. Aug. 30, 2019); *In re Valsartan N-Nitrosodimethylamine (NDMA) Contamination Prods. Liab. Litig.*, 405 F. Supp. 3d 612 (D.N.J. 2019); *MLC Intellectual Prop., LLC v. Micron Tech., Inc.*, No 14-CV-03657, 2019 WL 118595 (N.D. Cal. Jan. 7, 2019); *Pipkin v. Acumen*, 2019 U.S. Dist. LEXIS 206233 (D. Utah Nov. 26, 2019); *Quan v. Peghe Deli Inc.*, 2019 N.Y. Misc. LEXIS 4516, 2019 WL 3974786 (Sup. Ct. Quens County 2019); *V5 Techs. v. Switch, Ltd.*, 334 F.R.D. 306 (D. Nev. 2019); *Williams v. IQS Ins. Risk Retention*, No. 18-2472, 2019 U.S. Dist. LEXIS 30217, at *10 (E.D. La. Feb. 25, 2019); *Art Akiane LLC v. Art & SoulWorks LLC*, No. 19 C 2952, 2020 U.S. Dist. LEXIS 171682 (N.D. Ill. Sep. 18, 2020); *Cont'l Circuits LLC v. Intel Corp.*, 435 F. Supp. 3d 1014 (D. Ariz. 2020); *Elm 3DS Innovations Ltd. Liab. Co. v. Samsung Elecs. Co.*, No. 14-1430-LPS, 2020 U.S. Dist. LEXIS 216796 (D. Del. Nov. 19, 2020); *Impact Engine, Inc. v. Google LLC*, No. 3:19-cv-01301-CAB-DEB, 2020 U.S. Dist. LEXIS 194517 (S.D. Cal. Oct. 20, 2020); *Pres. Techs. LLC v. MindGeek USA Inc.*, Case No. 2:17-cv-08906, 2020 U.S. LEXIS 258311 (C.D. Cal., Dec. 18, 2020); *United Access Techs., LLC v. AT&T Corp.*, 2020 U.S. Dist. LEXIS 103532 (D. Del. June 12, 2020); *Allele Biotechnology & Pharm. v. Pfizer*, Inc., No. 20-cv-01958-H-AGS, 2021 U.S. Dist. LEXIS 174654, at *4 (S.D. Cal. Sep. 13, 2021); Beam v. Watco Cos., L.L.C., No. 3:18-CV-02018-SMY-GCS, 2021 U.S. Dist. LEXIS 137915 (S.D. Ill. Jan. 20, 2021); *Colibri Heart Valve LLC v. Medtronic CoreValve LLC, et al.*, 8:20-cv-00847-DOC-JDE, ECF No. 111 (C.D. Cal. Mar. 26, 2021); *Coronda v. Veolia N. Am.*, 2021 NYLJ LEXIS 298 (N.Y. Sup. Ct. Apr. 13, 2021); *Edelson v. Edelson*, No. CV N20M-09-140, 2021 WL 195035 (Del. Super. Ct. Jan. 20, 2021); *Neural Magic Inc v. Facebook Inc*, No. 1:20-cv-10444 (D. Mass. December 21, 2021), ECF No. 224 (electronic order); *United States v. McKesson Corp. et al.*, 1:12-cv-06440-NG-ST, ECF No. 135 (E.D.N.Y., Apr. 28, 2021); *Advanced Aerodynamics, LLC v. Spin Master, Ltd.*, No. 6:21-cv-00002-ADA (W.D. Tex. Feb. 4, 2022); *Fleet Connect Sols. LLC v. Waste Connections US, Inc.*, 2022 U.S. Dist. LEXIS 129216 (E.D. Tex.) (June 29, 2022) (ECF No. 59); *Garcia v. City of N.Y.*, 2022 NY Slip Op 33333(U), 2022 N.Y. Misc. LEXIS 5482, Index No. 161140/2017, ¶ 3 (Sup. Ct. N.Y. Cnty., Oct. 3, 2022); *Hardin v. Samsung Elecs. Co., Ltd.*, No. 2:21-CV-00290-JRG, 2022 U.S. Dist. LEXIS 194602 (E.D. Tex. Oct. 25, 2022); *Kove IO, Inc. v. Amazon Web Services, Inc.*, 18-cv-8175 (N.D. Ill., January 26, 2022), ECF No. 497; *Nantworks, LLC v. Niantic, Inc.*, 2022 U.S. Dist. LEXIS 87320 (N.D. Cal. May 12, 2022); *Riseandshine Corporation d/b/a Rise Brewing v. PepsiCo, Inc.*, 21-cv-6324, 2022 WL 1118890 (S.D.N.Y., March 3, 2022), ECF No. 197; *Rodriguez v Rosen & Gordon, LLC*, 2022 N.Y. Misc. LEXIS 1084 (N.Y. Sup. Ct. Mar. 4, 2022); *Taction Technology, Inc. v. Apple Inc.*, No. 21-cv-812, 2022 WL 18781396 (S.D. Cal. Mar. 16, 2022) (ECF No. 44); *Thimes Solutions Inc. v. TP-Link USA Corp.*, No. 19-10374, 2022 WL 18397128 (C.D. Cal. Oct. 6, 2022); *Worldview Entertainment Holdings, Inc. v Woodrow*, 204 A.D.3d 629, 2022 N.Y. App. Div. LEXIS 2790 (N.Y. App. Div. Apr. 28, 2022); *Centripetal Networks, LLC v. Palo Alto Networks, Inc.*, No. 2:21-137 (E.D. Va. Aug. 16, 2023); *GoTV Streaming, LLC v.*

case, the court did not discuss discovery of the funding agreement and allowed very limited discovery of a few non-deal documents, which were redacted.[13] Similarly, in a divorce proceeding, a litigation funder was ordered to produce financial information provided to the litigation funder by the litigant.[14] However, beyond this situation being quite rare, courts have quashed subpoenas served on litigation funders for information related to the funded party when the litigation funder is a non-party to the case. [15] Finally, in another case, the court ruled that funding agreements are protected by the work product doctrine, but information about the identities of the funder was not.[16]

Category Two – Limited Discovery Allowed. Second, in twelve of the 106 decisions analyzed, the court held some, but not all, of the material shared with funders deserved protection from discovery. In nine of these cases, the respondent raised a work-product defense.[17] In two of these instances, the

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Netflix, Inc., No. 2:22-07556-RGK-SHK, 2023 WL 4237609 (C.D. Cal. May 24, 2023); *SiteLock LLC v. GoDaddy.com LLC*, No. 19-02746-PHX-DWL, 2023 WL 3344638 (D. Ariz. May 10, 2023).

[13] *Doe v. Soc'y of Missionaries of Sacred Heart*, No. 11-CV-02518, 2014 WL 1715376 (N.D. Ill. May 1, 2014).

[14] *Edelson v. Edelson*, No. CV N20M-09-140, 2021 WL 195035, at *2 (Del. Super. Ct. Jan. 20, 2021) (ordering a litigation funding company to produce all financial statements and information presented to the company by the litigant, the amounts disbursed in loans to the litigant, and the amounts received from the litigant as repayment but denied the respondent's request for production of the loan documents which included proprietary terms and conditions).

[15] *Mobile Telecomms. Techs. LLC v. Blackberry Corp.*, No. 3:12-cv-01652 (N.D. Tex. Nov. 2, 2015).

[16] *Cont'l Circuits LLC v. Intel Corp.*, 435 F. Supp. 3d 1014, 1024 (D. Ariz. 2020).

[17] *Caryle Inv. Mgmt. L.L.C. v. Moonmouth Co. S.A.*, No. 7841-VCP, 2015 WL 778846 (Del. Ch. Feb. 24, 2015); *Charge Injection Techs., Inc. v. E.I. DuPont De Nemours & Co.*, No. CV 07C-12-134-JRJ, 2015 WL 1540520 (Del. Super. Ct. Mar. 31, 2015); *Morley v. Square, Inc.*, No. 4:10CV2243 SNLJ, 2015 WL 7273318, 2015 U.S. Dist. LEXIS 155569 (E.D. Mo. Nov. 18, 2015); *In re Int'l Oil Trading Co., LLC*, 548 B.R. 825, 832 (Bankr. S.D. Fla. 2016); *Elenza, Inc. v. Alcon Labs.*, No. N14C-03-185 MMJ CCLD (Del. Super. Ct. June 14, 2016); *Odyssey Wireless, Inc. v. Samsung Elecs. Co., Ltd*, No. 315CV01735HRBB, 2016 WL 7665898, 2016 U.S. Dist. LEXIS 188611 (S.D. Cal. Sept. 20, 2016); *Alabama Aircraft Indus. v. Boeing Co.*, No. 2:16-mc-01216-RDP, at *31, 33, 49 (N.D. Ala. Feb. 9, 2018; *SecurityPoint Holdings, Inc. v. United States*, No. 1:11-CV-00268, 2019 WL 1751194, at *5-6 (Fed. Cl. Apr. 16, 2019) (recognizing both work-product protection and an objection that the discovery request was not relevant to a claim or defense) (*see also* ECF No. 404, denying motion to compel production of unredacted funding agreement because *in camera* review showed redacted portions of agreement were not relevant); *Fulton v. Foley*, No. 17-CV-8696, 2019 U.S. Dist. LEXIS 209585, at *11 (N.D. Ill. Dec. 5, 2019) (ordering plaintiff to disclose "all non-mental impressions, fact-based information and documents including any statements provided by Plaintiff directly, if any, that was provided to [the funder].").

respondent augmented this defense with argument about attorney client privilege. Of the remaining three cases in Category Two, the respondent objected to turning over the discovery based on relevance twice[18] and relied solely on attorney client privilege once.[19] In several cases, the court only allowed discovery of the funding agreement in redacted form to protect work-product in that document.[20] In four instances, the court remained silent as to discovery of the funding agreement, but compelled discovery of non-deal documents.[21]

Category Three – Significant Discovery Allowed. In thirty-four cases, courts compelled significant discovery of information from litigation funders. In some of these cases, there was not much case law on this issue at the time of decision, or the respondent failed to raise all the usual objections. However, in a majority of instances, discovery was permitted even after the respondent raised work-

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[18] *Queens Univ. v. Samsung Elecs.*, No. 2:14CV53-JRG-RSP (E.D. Tex. Apr. 10, 2015); *Cirba Inc. v. Vmware, Inc.*, No. 19-742-LPS, 2021 LEXIS 238484 (D. Del. Dec. 14, 2021).

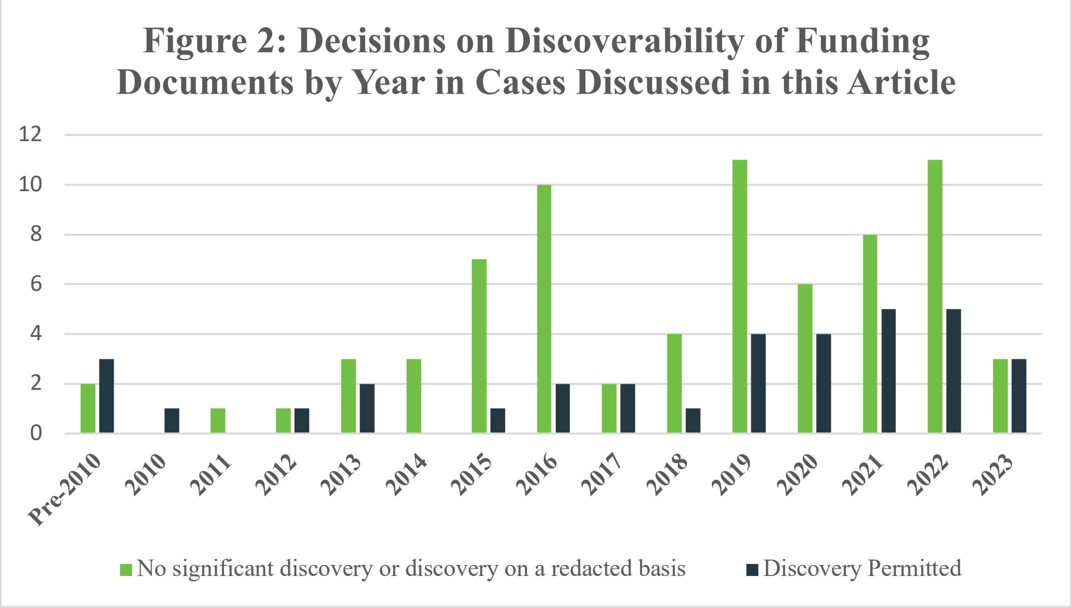
[19] *Intellectual Ventures I LLC v. Altera Corp.*, No. 10-1065-LPS, ECF No. 415, at *12 (D. Del. Jul. 25, 2013).

[20] *E.g.*, *SecurityPoint Holdings, Inc. v. United States*, No. 1:11-CV-00268, 2019 WL 1751194, at *5-6 (Fed. Cl. Apr. 16, 2019); *Elenza, Inc. v. Alcon Labs.*, No. N14C-03-185 MMJ CCLD (Del. Super. Ct. June 14, 2016); *In re Int'l Oil Trading Co., LLC*, 548 B.R. 825, 832 (Bankr. S.D. Fla. 2016); *Queens University, et. al. v. Samsung Elecs.*, No. 2:14CV53-JRG-RSP (E.D. Tex. Apr. 10, 2015); *Charge Injection Techs., Inc. v. E.I. DuPont De Nemours & Co.*, No. CV 07C-12-134-JRJ, 2015 WL 1540520 (Del. Super. Ct. Mar. 31, 2015); *Carlyle Inv. Mgmt. L.L.C. v. Moonmouth Co. S.A.*, No. CV 7841-VCP, 2015 WL 778846 (Del. Ch. Feb. 24, 2015); *Fulton v. Foley*, No. 17-CV-8696, 2019 U.S. Dist. LEXIS 209585, at *11 (N.D. Ill. Dec. 5, 2019) (ordering plaintiff to disclose "all non-mental impressions, fact-based information and documents including any statements provided by Plaintiff directly, if any, that was provided to [the funder].").

[21] *Odyssey Wireless, Inc. v. Samsung Elecs. Co., Ltd*, No. 315CV01735HRBB, 2016 WL 7665898, 2016 U.S. Dist. LEXIS 188611 (S.D. Cal. Sept. 20, 2016); *Morley v. Square, Inc.*, No. 4:10CV2243 SNLJ, 2015 WL 7273318, 2015 U.S. Dist. LEXIS 155569 (E.D. Mo. Nov. 18, 2015). As in the cases compelling disclosure of the redacted funding agreement, both the *Odyssey* and *Morley* courts allowed for redaction of privileged information or work-product in the non-deal documents produced. The *Alabama Aircraft Indus.* court held that "providing a draft complaint to a litigation funding source does not waive the work-product privilege," but the court allowed discovery of two emails with a funder where only attorney-client privilege was claimed, *Alabama Aircraft Indus. v. Boeing Co.*, No. 2:16-mc-01216-RDP, at *31, 33, 49 (N.D. Ala. Feb. 9, 2018). We categorized that case here and with the cases allowing only redacted discovery because the emails did not appear to be about obtaining litigation funding nor was work-product protection asserted for them. *See id.* In *Cirba Inc. v. Vmware, Inc.*, No. 19-742-LPS, 2021 LEXIS 238484 (D. Del. Dec. 14, 2021), the court announced that only documents that describe or explain the value of the challenged patent are relevant. This provides an avenue for the funder to prevent the funding documents from being discovered.

product, attorney client, and relevance objections.[22] Section IV analyzes nine of these cases in depth and discusses why a minority of courts are persuaded by Category Three precedent.

Overall, sixty-eight percent of cases we found did not allow much, if any, discovery of information shared with litigation funders. This number grows to seventy-five percent when the respondent presents arguments about work-product, attorney client privilege, and relevance or some combination these arguments.



Over time, this pattern holds. Since 2011, each year has seen more courts denying discovery requests related to litigation funding than granting them.[23] This trend holds despite the rise in incidents over time as illustrated by the upward slope of the bar graph in Figure 2. Additionally, most of the leading decisions allowing significant discovery of the funding agreement and non-deal documents in the face of a strong work-product argument by the plaintiff were decided several years ago, before the decision in *Miller v. Caterpillar* in 2014, the

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[22] In 10 out of the 34 Category Three cases, work-product, attorney client, and relevance objections were not raised. *E.g.*, *In re Gawker Media LLC*, 2017 Bankr. LEXIS 1798, 2017 WL 2804870 (Bankr. Ct. S.D. NY 2017) (permitting discovery of litigation funding agreements based on a specific Bankruptcy Court rule that allowed the trustee of the bankruptcy to identify and pursue claims against non-parties in order to recoup money for the bankrupt estate).

[23] In 2010, there is only one case in our data set and in that case the court allowed discovery. *Leader Techs., Inc. v. Facebook, Inc.*, 719 F. Supp. 2d 373, 376 (D. Del. 2010). Complete information is not available for 2023, as the year is not yet complete.

leading decision in this area.[24] The *Acceleration Bay* decision in 2018 was an exception to this trend, but it involved unusual facts and did not distinguish prior cases in a way likely to prompt other courts to depart from the current majority view.

III. WHY COURTS DENY DISCOVERY OF FUNDING DOCUMENTS

Among other requirements for discovery under Federal Rule of Civil Procedure 26, a document must be relevant to a party's claim or defense to be discoverable. Relevant information might still not be discoverable if it is protected by the attorney-client privilege or the work-product doctrine. As discussed in the three sections below, courts deny requests for discovery of litigation funding agreements and non-deal documents because these documents are not relevant, are protected by attorney-client privilege, or are protected work-product. When a plaintiff discloses privileged information or work-product to a third-party, that disclosure may lead to waiver of attorney-client privilege or work-product protection, but exceptions and limits on waiver allow funding documents to retain these protections.

Figure 3 illustrates how often a court has found each of these grounds persuasive when deciding to limit, at least to some extent, a defendant's request for discovery of funding documents. Although each of these three grounds alone has sufficed to deny discovery of any funding documents, courts most often deny or limit discovery of funding documents on relevance grounds. The minority of courts permitting discovery of funding documents did so most often due to a finding of no work-product protection or finding the litigation funding documents relevant.

A. The Requirement of Relevance for Funding Documents to be Discoverable

As a threshold matter in federal court, a party may only discover a "nonprivileged matter that is relevant to any party's claim or defense."[25] Defendants have argued funding documents are relevant to determine:

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[24] *See Leader*, 719 F. Supp. 2d at 376 (2010); *Conlon*, 2004 Mass. LCR LEXIS 56, at *5 (Mass. Land Ct. July 21, 2004). The *Miller* decision was issued in 2014. *Miller UK Ltd. v. Caterpillar, Inc.*, 17 F. Supp. 3d 711 (N.D. Ill. 2014). We found more courts have cited *Miller* more than any other case on this issue.

[25] Fed. R. Civ. P. 26(b)(1) (emphasis added).

- the adequacy of class counsel;[26]
- if the plaintiff no longer has standing because the patent or claim was transferred;[27]
- whether funders are indispensable parties or witnesses;[28]
- whether a funder declined to take a case because the patent in an infringement suit is invalid;[29]
- whether the plaintiff's claims are barred under the statute of limitations; and[30]
- "possible bias issues" with jury members and witnesses.[31]

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[26] *Kaplan*, 2015 U.S. Dist. LEXIS 135031, at *17-18; *Gbarabe* 2016 U.S. Dist. LEXIS 103594, at *5-6.

[27] *See VHT*, 2016 U.S. Dist. LEXIS 172373, at *3; *In re Int'l Oil*, 548 B.R. at 838-39; *Cobra*, 2013 U.S. Dist. LEXIS 190268, at * 8-9; *see also SecurityPoint Holdings*, 2019 WL 1751194, at *5-6 (where Defendant United States also argued the Assignment of Claims Act, 31 U.S.C. § 3727, could make a litigation funding arrangement relevant).

[28] *VHT*, 2016 U.S. Dist. LEXIS 172373, at *4.

[29] Transcript, *IOENGINE*, No. 1:14-cv-01571 (D. Del. Jul. 18, 2016).

[30] *Doe*, 2014 WL 1715376, at *2 (finding the funding documents relevant and contrasting the statute of limitations issue here with *Miller* where the documents were not relevant).

[31] *Micron,* 2019 WL 118595, at *1; *Berger*, 2008 WL 4681834, at *1 (where funder was a witness in case). A variation of this argument was made in the civil rights case against City of New York. In *Benitez v. Lopez*, the Defendants contended that funding was relevant to the Plaintiff's "motives," the Plaintiff's "credibility . . . and [would be] grounds for impeachment at trial." 2019 WL 1578167 at *1. The Eastern District of New York held "the financial backing of a litigation funder is as irrelevant to credibility as the Plaintiff's personal financial wealth . . ." *Id.*

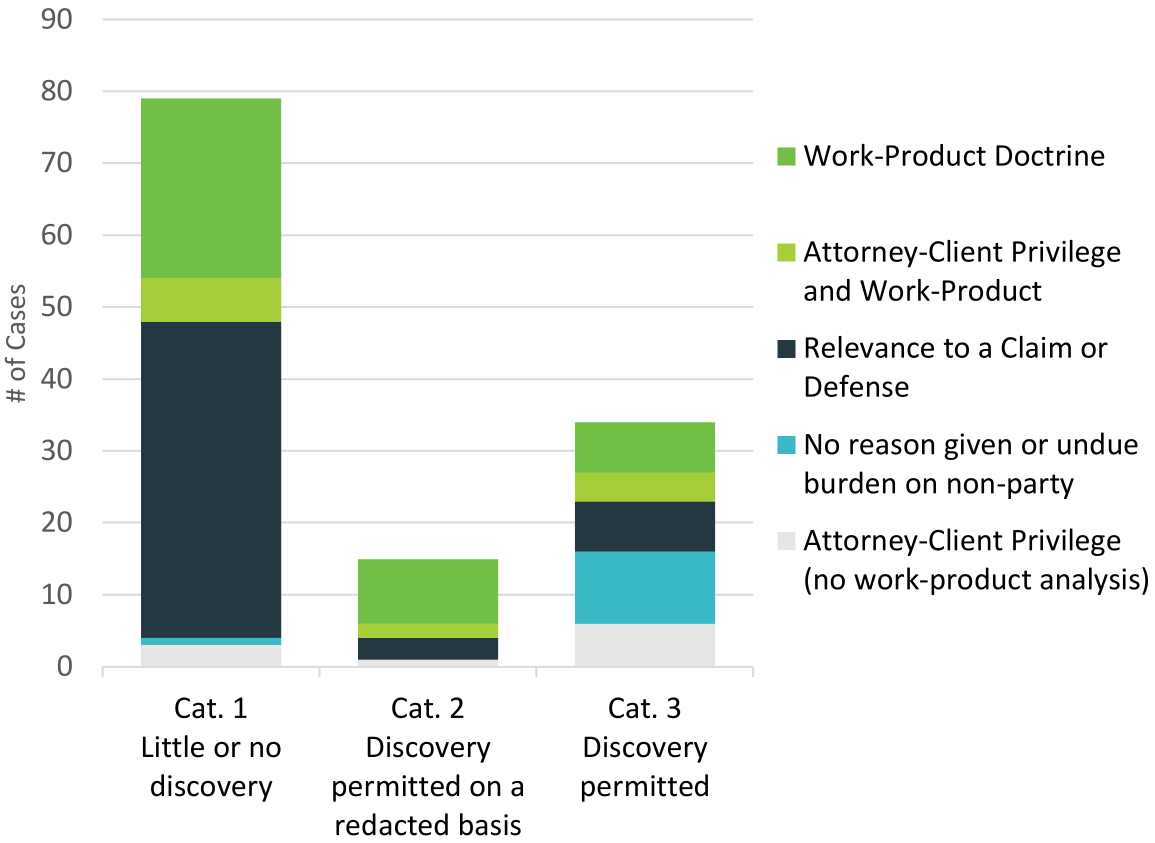

Figure 3: Primary Basis for Deciding Discovery Disputes Discussed in this Article

The relevancy threshold is fairly low, allowing for expansive discovery.[32] Hence, many courts do not deny discovery of funding documents on this basis.[33] Nevertheless, in forty-four cases, courts denied some discovery requests because

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[32] For example, information "need not be admissible in evidence to be discoverable." Fed. R. Civ. P. 26(b)(1).

[33] Although this article focuses on the discovery of litigation documents prior to trial, at least two district courts have considered the relevancy of litigation funding documents in the post-judgment context. *See Stan Lee Media, Inc. v. Walt Disney Co.*, No. 12-CV-02663-WJM-KMT, 2015 WL 5210655 (D. Col. Sept. 8, 2015) (holding discovery of litigation funding information was permitted where a party argued the funder should be a "party" for the purpose of executing judgments where attorney's fees and costs were assessed); *Tradeline Enterprises PVT. Ltd v. Smith & Sons Cotton, LLC*, No. LA-CV15-08048-JAK, 2019 WL 6898959 (C.D. Cal. Apr. 15, 2019) (permitting discovery of litigation funding information where the request was related to a motion to add a litigation funder as a judgment debtor).

the funding agreement or communications with funders were not relevant to a claim or defense.[34]

Courts are most likely to find information related to litigation funding irrelevant where parties make broad discovery requests based on blanket assertions of relevancy. For instance, in *In re Valsartan N-Nitrosodimethylamine (NDMA) Contamination Prods. Liab. Litig.*, the District of New Jersey denied defendants' request for "carte blanche discovery of plaintiff's litigation funding" in a mass tort case where defendants claimed the information was relevant to, among other things, plaintiffs' credibility and bias and the scope of proportional discovery.[35] However, the court specified that it was "not ruling that litigation funding is off-limits in all instances," and "[i]n cases where there is a showing that something untoward occurred, the discovery could be relevant."[36] Similarly, in *V5 Techs. v. Switch, Ltd*., the District of Nevada held that where parties seek

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[34] The court found funding documents and communications not relevant in: *SecurityPoint*, No. 1:11-CV-00268, 2019 WL 1751194 (Fed. Cl. 2019) (see ECF Nos. 303, 404); *Benitez*, 2019 WL 1578167, at *1; *Micron*, 2019 WL 118595, at *2 (N.D. Cal. 2019); *Space Data*, 2018 WL 3054797, at *1 (N.D. Cal. 2018); *Mackenzie*, 2017 WL 4898743, at *3 (N.D.N.Y. 2017); *Telesocial*, No. 3:14-cv-03985 (N.D. Cal. 2016); *VHT, Inc. v. Zillow Group, Inc.*, 2016 WL 7077235, 2016 U.S. Dist. LEXIS 172373 (W.D Wash. Sept. 8, 2016); *Kaplan*, 2015 U.S. Dist. LEXIS 135031, at *18; *V5 Techs.*, 334 F.R.D. at 312; *Art Akiane LLC*, 2020 U.S. Dist. LEXIS 171682, at *7, *15; *United Access Techs., LLC,* 2020 U.S. Dist. LEXIS 103532, at *3; *In re Valsartan,* 405 F. Supp. 3d at 615; *Pipkin*, 2019 U.S. Dist. LEXIS 206233, at *3; *Dupont*, 2019 WL 8158471, at *5; *Elm 3DS Innovations Ltd. Liab. Co.*, 2020 U.S. Dist. LEXIS 216796, at *3–4; *Colibri Heart Valve LLC,* 8:20-cv-00847-DOC-JDE, ECF. 111 at *6; *Speyside Medical, LLC*, 1:20-cv-00361-LPS, ECF No. 88**;** *Michelson*, 2003 U.S. Dist. LEXIS 25198, at *1-4; *1279 Morris LLC*, 2012 WL 5418611, at *1-4; *Ashghari-Kamrani*, 2016 WL 11642670, at *14-15; Harper, 2016 U.S. Dist. LEXIS 197894, at *11-12; *Hylete*, 2019 U.S. Dist. LEXIS 148245, at *37-38; *Quan*, 2019 N.Y. Misc. LEXIS 4516, at *7; *MindGeek*, 2020 U.S. LEXIS 258311, at *16-20; *Pfizer*, 2021 U.S. Dist. LEXIS 174654, at *4; *Beam*, 2021 U.S. Dist. LEXIS 137915, at *3-6; *Coronda*, 2021 NYLJ LEXIS 298, at *1-5; *Neural Magic*, No. 1:20-cv-10444 (D. Mass. December 21, 2021), ECF No. 224; *Waste Connections US*, 2022 U.S. Dist. LEXIS 129216 (ECF No. 59); *Garcia*, 2022 N.Y. Misc. LEXIS 5482, at *3; *Hardin*, 2022 U.S. Dist. LEXIS 194602, at *6-8; *Kove IO*, 18-cv-8175 (N.D. Ill., January 26, 2022), ECF No. 497; *Nantworks*, 2022 U.S. Dist. LEXIS 87320, at *2-3; *Rise Brewing*, 2022 WL 1118890, at *2; *Rodriguez*, 2022 N.Y. Misc. LEXIS 1084, at *4-6; *Taction Tech.*, 2022 WL 18781396, at *2-6; *Woodrow*, 204 A.D.3d 629, 629-30; *Centripetal Networks*, No. 2:21-137, (E.D. Va. Aug. 16, 2023) (ECF No. [XX]); *SiteLock*, 2023 WL 3344638, at *18-24. In *Miller* the "deal documents" were not relevant to a cogent argument. *Miller*, 17 F. Supp. 3d at 724 (finding the deal documents relevant only to arguments without "any cogency").

[35] *In re Valsartan*, 405 F. Supp. 3d at 619.

[36] *Id.* at 615.

litigation funding information to expose potential bias, "[m]ere speculation by the party seeking this discovery will not suffice."[37]

In three intellectual property cases out of the Northern District of California and in one business dispute, courts found the defendants' requests for funding documents not relevant. "Even if litigation funding were relevant (which is contestable), *potential* litigation funding is a side issue at best."[38] In *VHT, Inc. v. Zillow Group, Inc.*, the defendant made several unsubstantiated and speculative arguments, such as that an agreement to assign recovery in the case would be relevant to whether the plaintiff "has standing to pursue its copyright infringement claims."[39] Even after allowing the defendant to file amended counterclaims, the court found that "[n]othing more than speculation supports [the defendant's] arguments," which consisted of "imaginable hypotheticals."[40] Therefore, the requested litigation funding information was "disproportional to the needs of the case," so the court denied the defendant's motion to compel.[41]

In class actions, defendants have argued litigation funding documents are relevant to the defendant's determination of the adequacy of class counsel under Federal Rule of Civil Procedure 23(g).[42] This argument has not always been

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[37] *V5 Techs.*, 334 F.R.D. at 312. Courts in other districts have also found that broad requests for discovery of litigation funding information are irrelevant for bias or impeachment purposes. *See Art Akiane LLC*, 2020 U.S. Dist. LEXIS 171682, at *15 ("[B]roadly asking in discovery for 'documents relating to third-party funding for this litigation' is insufficient without some detailed, meaningful explanation to satisfy the requirement of relevancy."); *Pipkin*, 2019 U.S. Dist. LEXIS 206233, at *4 (rejecting defendant's argument that plaintiff's funding arrangement was relevant to the credibility and bias of a witness and deeming the argument "entirely speculative and insufficient to demonstrate the relevance of the sought-after fee agreements.").

[38] *Space Data*, 2018 WL 3054797, at *1. Judges reached the same conclusion in two other Northern District of California cases. *Micron*, 2019 WL 118595, at *2; *Telesocial*, No. 3:14-cv-03985 (N.D. Cal. Sept. 30, 2016).

[39] *VHT*, 2016 U.S. Dist. LEXIS 172373, at *3-4.

[40] *Id.* at *4.

[41] *Id.*

[42] *See Kaplan*, 2015 U.S. Dist. LEXIS 135031, at *16-17. *See also Gbarabe*, 2016 U.S. Dist. LEXIS 103594, at *3-4. This issue arises is especially likely to arise in class actions in the Northern District of California because that district has adopted a standing order making the disclosure required for class action sunder Civil Local Rule 3-15 include disclosure of "any person or entity that is funding the prosecution of any claim or counterclaim." *See* https://www.cand.uscourts.gov/filelibrary/373/ Standing_Order_All_Judges_1.17.2017.pdf. A survey of disclosure rules for litigation funding then in existence can be found in a Memorandum by Patrick A. Tighe in the Advisory Committee on Civil Rules, Agenda Materials, Philadelphia,

successful in persuading a court to allow discovery. For example, in *Kaplan v. S.A.C. Capital Advisors, L.P.*, the Southern District of New York found "purely speculative" all the reasons the defendants claimed they were entitled to discovery, including the claim that "the funding agreements 'could cause class counsel's interest to differ from those of the putative class . . .'"[43] "The plaintiffs' admission that they have entered into a litigation funding agreement does not, of itself, constitute a basis for questioning counsel's ability to fund the litigation adequately."[44] The court denied the defendants' motion to compel production of litigation funding documents.[45] In *Gbarabe v. Chevron Corp.*, a class action (and a very unusual case), the Northern District of California ordered production of the entire funding agreement, unredacted, but unlike in *Kaplan*, the plaintiff in *Gbarabe* conceded the relevance of the funding agreement "to the class certification adequacy determination" and also did "not assert that the agreement is privileged."[46]

B. The Applicability of Attorney-Client Privilege to Funding Documents

The attorney-client privilege protects confidential communications, oral or written, between a client and his lawyer who is providing him legal advice. The party asserting the privilege bears the burden of proving the privilege applies to the documents sought in discovery. "Since the purpose behind the attorney-client privilege is to encourage full disclosure to one's lawyer by assuring confidentiality," the client or attorney waives the privilege if he destroys confidentiality of the communications by disclosing their content to a third-party.[47] However, courts recognize various exceptions to this general rule of automatic waiver for breaches of confidentiality.[48] The party asserting the

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PA, April 10, 2018, at 209, available at http://www.uscourts.gov/sites/ default/files/2018-04-civil-rules-agenda-book.pdf.

[43] *Kaplan*, 2015 U.S. Dist. LEXIS 135031, at *16-17.

[44] *Id.* at *17.

[45] *Id.* at *17-18.

[46] *See Gbarabe*, 2016 U.S. Dist. LEXIS 103594, at *4; *Kaplan*, 2015 U.S. Dist. LEXIS 135031, at *14. Later, in the more typical *Micron* case, Judge Susan Illston, who had permitted the discovery in the *Gbarabe v. Chevron* case, held discovery into litigation funding was not relevant. *Micron*, 2019 WL 118595, at *2.

[47] *Miller*, 17 F. Supp. 3d at 731.

[48] *See generally* Jeffrey Schacknow, Comment, *Applying the Common Interest Doctrine to Third-Party Litigation Funding*, 66 Emory L. J. 1461, 1467-80 (2017); Ani-Rae Lovell, Note, *Protecting Privilege: How Alternative Litigation Finance Supports an Attorney's Role*, 28 Geo. J. Legal Ethics 703,

privilege also bears the burden of proving an exception to waiver of the privilege if a disclosure broke the confidentiality required.[49]

In commercial litigation funding cases, the attorney-client privilege may not apply to the funding agreement because that is a contract between the client and a third party, not a confidential communication from client to lawyer.[50] Similarly, attorney-client privilege generally may not attach to non-deal documents or communications that were not shared between the attorney and client.[51] If the information shared with a funder is privileged, then sharing that information with the litigation funder waives the privilege unless an exception applies. There are two potentially applicable exceptions to this waiver of attorney-client privilege: the common interest doctrine and the less frequently used agency exception to waiver.

1. The Common Interest Doctrine

The common interest doctrine "allows communications that are already privileged to be shared between parties having a "common legal interest" without a waiver of the privilege. It does not broaden the overall applicability of attorney-client privilege. Rather, it preserves "an already-existing privilege" that would otherwise be waived by disclosure.[52] In litigation funding cases, this doctrine is the most commonly analyzed exception to waiver of attorney-client privilege. Some courts insist on a "common legal interest" in contrast to a common commercial interest, whereas others define the interest more broadly as a "common enterprise." Overall, there is a split in how courts define the "common interest" required. This divergence in the case law has led directly to divergent results in the cases we reviewed: twelve of the twenty-three cases we

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704 (2015); Grace M. Giesel, *Alternative Litigation Finance and the Attorney-Client Privilege*, 92 Denv. U. L. Rev. 95, 104-118 (2014); Michele DeStefano, *supra* note 2.

[49] 6-26 *Moore's Federal Practice - Civil* § 26.47 (2017).

[50] *In re Int'l Oil Trading Co.*, 548 B.R. at 831 ("As a threshold matter, the Funding Agreement is primarily a contract, not a communication. Under both federal and Florida law, attorney-client privilege applies only to communications, not to contracts.").

[51] *See Miller*, 17 F. Supp. 3d at 731; *see also Alabama Aircraft Indus. v. Boeing Co.*, No. 2:16-mc-01216-RDP, at *31, 33 (N.D. Ala. Feb. 9, 2018) (permitting discovery because the attorney-client privilege did not apply to a client's emails with a funder, which were not about obtaining funding).

[52] Schacknow, *supra* note 35, at 1468.

found analyzing the issue concluded that the doctrine applies to funding documents.[53]

a) The Narrow View: "A Common Legal Interest"

Some courts narrowly define the common interest doctrine as "an exception to ordinary waiver rules designed to allow attorneys for different clients pursuing a common legal strategy to communicate with each other."[54] We found several cases where the doctrine was held not to apply to funding documents because the court required and did not find a "common legal interest" between the funder and plaintiff.[55] In analyzing the discoverability of non-deal documents, the seminal *Miller* decision held that a "shared rooting interest in the "successful outcome of a case…is not a common legal interest" because the doctrine is designed to facilitate seeking legal advice or litigation strategies, which a prospective funder does not offer.[56] The District of Delaware reached the same conclusion in patent infringement suits in 2010 and in 2018.[57] A federal court applying New York law described a plaintiff's relationship with litigation funders as "inherently financial," so the common interest exception did not apply to the waiver of privilege for funding documents.[58]

Nonetheless, some courts apparently requiring a "common legal interest" have found the doctrine applies to litigation funding documents. Two short orders from federal courts in 2012 and 2013 state that the common interest doctrine provided an exception to the rule of waiver for privileged funding documents.[59] In both of those cases, a common interest and non-disclosure

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[53] *See Walker*, *Devon*, *Rembrandt*, and *In re International Oil Trading Co.* discussed below for cases finding the common interest exception applies.

[54] *In re Pacific Pictures Corp. v. United States Dist. Court*, 679 F.3d 1121, 1129 (9th Cir. 2012) (a case not involving commercial litigation funding).

[55] *Acceleration Bay*, 2018 U.S. Dist. LEXIS 21506, at *6-9; *Cohen*, 2015 WL 745712, at *4; *Miller*, 17 F. Supp. 3d at 732-33; *Leader*, 719 F. Supp. 2d at 376; *Midwest Ath. & Sports All. LLC*, 2020 U.S. Dist. LEXIS 169770, at *6; *In re Dealer*, 2020 U.S. Dist. LEXIS 99767, at *44; *Medtronic Sofamor Danek, Inc. v. Michelson*, No. 01-2373, 2003 LEXIS 25198 (W.D. Tenn. Nov. 6, 2003) (holding that speculation that the respondent's legal fees were being paid by their competitor was too inextricably intertwined with privileged attorney-client communications).

[56] *Miller*, 17 F. Supp. 3d at 732-33.

[57] *Acceleration Bay*, 2018 U.S. Dist. LEXIS 21506, at *6-9; *Leader*, 719 F. Supp. 2d at 376.

[58] *Cohen*, 2015 WL 745712, at *4. *See also Kove IO, Inc. v. Amazon Web Services, Inc.*, 18-cv-8175 (N.D. Ill. Jan. 26, 2022) (ECF No. 497)

[59] *Walker*, No. 11-309-SLR, at 2 (holding that a patent monetization consultant and the plaintiff had a "common legal interest," even though the consultant was clearly "not a law firm

agreement was in place.[60] A few cases have cited these orders to support the conclusion that funding documents are privileged and not discoverable; but since 2013, however, we could not find any case that has protected funding documents on the ground that the funder and client have a "common legal interest."[61]

b) The Broader View: a "Substantially Similar Legal Interest" or a "Common Enterprise"

Other courts view the common interest doctrine more broadly, as illustrated in two decisions on denying discovery of funding documents. In *Rembrandt Techs., L.P. v. Harris Corp.*, a Delaware state court held that an agreement to enforce patents created a "common legal interest binding the parties" because they shared a "substantially similar" legal interest.[62] *In re International Oil Trading Co*. noted this split among federal courts on how broadly to define "common interest." Without any precedent binding it to one approach, the court chose to adopt the more expansive "common enterprise" approach, which it found more compelling and consistent with Florida law.[63] The common interest exception alone sufficed for the court to deny the defendant's motion to compel discovery of non-deal documents.[64]

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and was not retained to provide legal services"); *Devon*, 2012 WL 4748160, at *1 (holding that the common interest doctrine, which requires a "a shared common interest in litigation strategy," applies where the funder and plaintiff have a common interest in the successful outcome of the case).

[60] *Walker*, No. 11-309-SLR, at 2; *Devon*, 2012 WL 4748160, at *1. The *Acceleration Bay* decision suggests that a written common interest agreement would be necessary but not necessarily sufficient for a common legal interest to exist with a litigation funder. 2018 U.S. Dist. LEXIS 21506, at *8-9.

[61] Recently, the "common legal interest" doctrine has been explicitly rejected by several district courts. *E.g.*, *Hybrid Ath., LLC v. Hylete*, No. 3:17-1767, 2019 LEXIS 148245, at *37-38 (D. Conn. Aug. 30, 2019); *In re Outlaw Lab'ys, LP Litig.*, No. 18-840, 2021 WL 5768123 (S.D. Cal. June 29, 2021).

[62] *Rembrandt*, 2009 Del. Super. LEXIS 46, at *23-31 (Del. Super. Ct. Feb. 12, 2009) (citing *In re Teleglobe Commc'ns Corp.*, 493 F.3d 345, 365 (3d Cir. 2007) and *In re Regents of the University of California*, 101 F.3d 1386, 1390 (9th Cir. 1996) for the "substantially similar legal interest standard").

[63] *In re Int'l Oil Trading Co.*, 548 B.R. at 832-33.

[64] *Id.* at 833. The court also found the agency exception and work-product doctrine protected the non-deal documents. *Id.* at 835, 837. The court held the funding agreement was protected by the work-product doctrine, though this was overcome for part of the agreement as discussed below. *Id.* at 839.

2. Agency Doctrine

The agency doctrine, sometimes called the *Kovel* doctrine, operates in the same way as the common interest doctrine – as an exception to a waiver of attorney-client privilege. It "protects from discovery the necessary communications with" non-attorney professionals, such as an accountant.[65] Like the common interest exception, courts are split over how narrowly to limit the kinds of non-lawyer professionals the exception can cover.[66] In contrast to the more widely analyzed common interest doctrine discussed above, only one court has analyzed the applicability of the agency doctrine to waiver of attorney-client privilege for funding documents, though there is some academic support for applying it.[67]

In addition to holding the common interest doctrine applied to funding documents, *In re International Oil Trading Co*. held the agency doctrine applied to communications with a litigation funder.[68] As with the common interest doctrine discussed above, the court chose to apply the "broader approach to the "agency exception,"" which it found consistent with Florida law, federal law, and the purpose of the exception.[69] The court interpreted Florida law as protecting

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[65] *Id.* at 833; *see United States v. Kovel*, 296 F.2d 918 (2d Cir. 1961) (the first case to articulate this exception and applying the exception to an accountant).

[66] *In re Int'l Oil Trading Co.*, 548 B.R. at 834; DeStefano, *supra* note 2, 331-341 (2014).

[67] *In re Int'l Oil Trading*, 548 B.R. at 833-35. The court in *Cohen v. Cohen* alluded to the agency exception to waiver, but the court did not address it because the plaintiff withdrew any privilege argument. 2015 WL 745712, at *2 n.1. Also, the plaintiff in *Viamedia* argued for the agency exception, but the attorney-client privilege issue was not reached by the court since discovery was denied on the basis of work-product protection. Mem. of Law in Support of Pl. Viamedia, Inc.'s Opp'n to Def.'s Mot. To Compel Pl. to Produce Docs., at 10-11, May 17, 2017, Case No. 1:16-cv-05486, ECF No. 117. In *Midwest Ath. & Sports All. LLC*, the court applied the agency doctrine to determine whether communications between a plaintiff and a company that helped the plaintiff obtain litigation funding were protected by the attorney-client privilege and found that it did not apply because the plaintiff hired the company for a business transaction, not to render legal advice. *Midwest Ath. & Sports All. LLC,* 2020 U.S. Dist. LEXIS 169770, at *7.

See Ani-Rae Lovell, Note, *Protecting Privilege: How Alternative Litigation Finance Supports an Attorney's Role*, 28 Geo. J. Legal Ethics 703, 704 (2015) (arguing "that sharing documents with alternative litigation finance firms should not constitute waiver of attorney-client privilege under the *Kovel* doctrine if the party can demonstrate that" the funder's involvement "bolsters several of the recognized roles of the modern attorney.") *But see* Giesel, *Alternative Litigation Finance and the Attorney-Client Privilege, supra* note 35, at 139-140 (observing that most courts have a narrow view of the *Kovel* agency doctrine, so they will rarely apply it to litigation funders).

[68] *In re Int'l Oil Trading Co.*, 548 B.R. at 835.

[69] *Id.* at 834-35.

communications with any party who assists the client in obtaining legal services."[70] And some federal courts have applied the agency exception "to professionals with whom communication may be necessary for the provision of legal advice."[71] "Litigation funders may be essential to the provision of legal advice in" cases brought by a creditor with little money against well-funded debtor.[72] Thus, the agency exception applies to a waiver of attorney-client privilege for non-deal documents shared with a litigation funder.[73]

Thus, the agency exception provides a relatively new approach courts may take when analyzing the discoverability of funding documents, but most courts will probably continue to decide the issue more easily on the grounds of work-product protection, as discussed below. Neither party in *In re Int'l Oil Trading Co*. addressed the agency exception. Now, plaintiffs may consider the agency exception yet another argument that could only bolster their case. They should, however, be cautious about how they make all these arguments together. For instance, arguing that the plaintiff and funder have a common legal interest may be undermined by simultaneously arguing the funder serves as an independent non-attorney professional (who would not have the same legal interest in the way joint parties do).[74]

C. Work-Product Protection for Funding Documents

If a court does not consider funding documents protected by attorney-client privilege, they could still be protected by the work-product doctrine, as codified in the Federal Rules of Civil Procedure among other places. Rule 26(b)(3) states that a party may not ordinarily "discover documents and tangible things that are prepared in anticipation of litigation or for trial by or for another party or its representative (including the other party's attorney, consultant, surety, indemnitor, insurer, or agent)." The majority of federal courts broadly interpret "prepared in anticipation of litigation" as requiring that the documents were prepared "because of" litigation. A small minority of federal courts (most notably the Fifth Circuit) require the "primary motivating purpose" for creating the documents was litigation.[75] As with the assertion of attorney-client privilege, the

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[70] *Id.* at 834.

[71] *Id.*

[72] *Id.* at 835.

[73] *Id.*

[74] DeStefano, *supra* note 2, at 352.

[75] *See* DeStefano, *supra* note 2, at 355 n.239 (listing the Circuits that use the "because of" test and citing articles identifying the two tests); Giesel, *Alternative Litigation Finance and the Work-*

party asserting the privilege – here, the plaintiff – bears the burden of proving the documents satisfy the appropriate test.

Courts often hold that the work-product doctrine protects at least some material in the funding agreement and usually all non-deal documents.[76] Of the 106 cases we found, thirty-five courts have held that the work-product doctrine provided at least some protection for the information in documents shared with litigation funders.[77] It did not matter whether the material was prepared before litigation is filed.[78] Nor did it matter that the funding documents serve a "business purpose" because the "documents simultaneously also are litigation documents."[79] The court in *Miller* explained that an alternative rule denying

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Product Doctrine, *supra* note 2, at 1101. Also, the Wright & Miller treatise prefers the "because of" test, and it states that "the test should be whether, in light of the nature of the document and the factual situation in the particular case, the document can fairly be said to have been prepared or obtained because of the prospect of litigation." 8 Charles Alan Wright & Arthur R. Miller, *Federal Practice and Procedure* § 2024 (3d ed. 2017).

[76] Courts now observe many other decisions have concluded funding documents are protected work-product. *See, e.g.*, *Viamedia*, 2017 U.S. Dist. LEXIS 101852, at *6.

[77] *In re: Nat'l Prescription Opiate Litig.*, 2018 WL 2127807; *Alabama Aircraft Indus. v. Boeing Co.*, No. 2:16-mc-01216-RDP, at *49; *Lambeth*, 2018 WL 466045, at *5-6; *Viamedia*, 2017 U.S. Dist. LEXIS 101852; *Telesocial*, No. 3:14-cv-03985; *Odyssey*, 2016 U.S. Dist. LEXIS 188611; *IOENGINE*, No. 1:14-cv-01571; *Elenza*, No. N14C-03-185 MMJ CCLD; *In re Int'l Oil Trading Co.*, 548 B.R. at 832; *Fisher*, 2016 U.S. Dist. LEXIS 32910; *Morley*, 2015 WL 7273318; *Charge Injection*, 2015 WL 1540520; *Carlyle*, 2015 WL 778846; *Abi Jaoudi*, No. 2:91-cv-0785; *Doe*, 2014 WL 1715376; *Miller*, 17 F. Supp. 3d 711; *Walker*, No. 11-309-SLR; *Devon*, 2012 WL 4748160; *Mondis*, 2011 WL 1714304; *Rembrandt*, 2009 WL 402332; *Impact Engine, Inc.*, 2020 U.S. Dist. LEXIS 194517; *Cont'l Circuits LLC*, 435 F. Supp. 3d 1014; *Elm 3DS Innovations Ltd. Liab. Co.*, 2020 U.S. Dist. LEXIS 216796; *Fulton*, 2019 U.S. Dist. LEXIS 209585; *Hylete*, 2019 U.S. Dist. LEXIS 148245, at *37-38; *MindGeek*, 2020 U.S. LEXIS 258311, at *16-20; *Neural Magic*, No. 1:20-cv-10444 (D. Mass. December 21, 2021), ECF No. 224; *Hardin*, 2022 U.S. Dist. LEXIS 194602, at *6-8; *Kove IO*, 18-cv-8175 (N.D. Ill., January 26, 2022), ECF No. 497; *Nantworks*, 2022 U.S. Dist. LEXIS 87320, at *2-3; *Taction Tech.*, 2022 WL 18781396, at *2-6; *Thimes Solutions Inc. v. TP-Link USA Corp.*, No. 19-10374, 2022 WL 18397128 (C.D. Cal. Oct. 6, 2022); *GoTV Streaming, LLC*, 2023 WL 4237609, at *11-13; *SiteLock LLC*, WL 3344638, at *14.

[78] *See Alabama Aircraft Indus. v. Boeing Co.*, No. 2:16-mc-01216-RDP, at *49 (N.D. Ala. Feb. 9, 2018) (citing *Miller* and holding a draft complaint shared with a funder was protected work-product); *Mondis*, 2011 WL 1714304, at *3.

[79] *Carlyle*, 2015 WL 778846, at *9; *see Lambeth*, 2018 WL 466045, at *5 ("Even if the Court were to . . . consider the relationships to be commercial, the materials nonetheless fall within work-product immunity because they were communications with Plaintiff's agents and in anticipation of litigation."); *see also Miller*, 17 F. Supp. 3d at 735. ("Materials that contain counsel's theories and mental impressions created to analyze [the plaintiff's] case do not necessarily cease to be protected because they may also have been prepared or used to help [the plaintiff] obtain financing."); *Cont'l Circuits LLC*, 435 F. Supp. 3d at 1021 (holding "any business-sustaining

work-product protection for "dual purpose" documents would undermine the work-product doctrine by allowing discovery of attorneys' mental impressions and litigating strategies – "precisely the type of discovery that the Supreme Court refused to permit in Hickman," the seminal decision recognizing work-product protection.[80]

Several courts have found that funding documents satisfy the narrower "primary motivating purpose" test for work-product protection.[81] However, the District of Delaware in *Acceleration Bay* denied work-product protection for communications with a funder because it applied the Fifth Circuit's "primary motivating purpose" test, not the Third Circuit's "because of" litigation test.[82] Here, the choice of the "primary motivating purpose" test led the court to conclude the communications were primarily for the purpose of obtaining a loan since litigation had not commenced at that time.[83]

Besides *Acceleration Bay*, we found eight other cases that explicitly rejected work-product protection for funding documents.[84] The leading cases are *Bray*

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purpose of the litigation funding agreements in this case is 'profoundly interconnected' with the purpose of funding the litigation," and thus, the agreements constitute work product).

[80] *See Miller*, 17 F. Supp. 3d at 735 (quoting *United States v. Adlman*, 134 F.3d 1194, 1199 (2d Cir.1998)).

[81] *United States ex rel. Fisher v. Homeward Residential, Inc.*, No. 4:12-CV-461, 2016 U.S. Dist. LEXIS 32910 *15 (E.D. Tex. Mar. 15, 2016); *United States v. Ocwen Loan Servicing, LLC*, No. 4:12-CV-543, 2016 WL 1031157, 2016 U.S. Dist. LEXIS 32967 (E.D. Tex. Mar. 15, 2016) (substantively identical order as in related case of *United States ex rel. Fisher v. Homeward Residential, Inc.*); *Mondis*, 2011 WL 1714304, at *2-3 (E.D. Tex. May 4, 2011). A bankruptcy court outside the Fifth Circuit agreed. *See In re Int'l Oil Trading Co.*, 548 B.R. at 836 ("Even if the "primary purpose" test exists in the manner presented . . . it is satisfied by" all the written communications between the creditor and his funder).

[82] *Acceleration Bay*, 2018 U.S. Dist. LEXIS 21506, at *5-6.

[83] *Id.* A few years before, the Delaware Chancery Court predicted the choice of test "may be outcome-determinative." *Carlyle*, 2015 WL 778846, at *8 (citing DeStefano, *supra* note 2, at 355–61). Until *Acceleration Bay*, we had not found a decision where the choice of test changed the outcome of a case.

[84] *Bray*, 2008 WL 5054695; *Leader*, 719 F. Supp. 2d at 376; *In re Dealer Mgmt. Sys. Antitrust Litig.*, No. 18-C-864, 2020 U.S. Dist. LEXIS 99767 (N.D. Ill. June 8, 2020); *Midwest Ath. & Sports All. LLC v. Ricoh USA, Inc.*, No. 2:19-cv-00514-JDW, 2020 U.S. Dist. LEXIS 169770 (E.D. Pa. Sept. 16, 2020) (theorizing that work-product protections did not apply to litigation funding documents); *Gamon Plus, Inc. v. Campbell Soup Co.*, No. 1:15-cv-08940, 2020 WL 18284320 (N.D. Ill. May 26, 2022); *Broadband ITV, Inc. v. OpenTV Inc.*, No. 17-561922, 2019 WL 13170112 (Cal. Super. June 20, 2019); *Electrolysis Prevention Solutions, LLC v. Daimler Truck North America LLC*, No. 3:21-171-RJC-

and *Leader*. In 2008, the district court in *Bray* rejected blanket assertions of work-product protection during a deposition.[85] In 2010, the court in *Leader* upheld a magistrate's decision to allow discovery of non-deal documents as not clearly erroneous, but it did not analyze the work-product doctrine apart from claims of attorney-client privilege.[86] In 2020, although not expressly rejecting work-product protection, the Eastern District of Pennsylvania held that it "strongly" suspected that litigation funding documents were not protected because such documents were "transactional."[87]

The work-product doctrine has eroded slightly in several other cases allowing discovery of redacted funding agreements and redacted non-deal documents. For discovery of funding agreements, four decisions compelled production of the funding agreement while allowing the plaintiff to redact core opinion work-product.[88] The discovery allowed in these cases was minimal because the courts treated the funding agreements' strategically valuable terms (such as financial terms and possibility of success) as work-product. For discovery of non-deal documents, five decisions allowed discovery of non-deal documents with work-product redacted.[89] These courts granted work-product

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WCM, 2023 WL 4750822 (W.D.N.C. July 24, 2023); *BCBSM, Inc. v. Walgreen Co.*, No. 1:20-01929, 2023 WL 3737724 (N.D. Ill. May 31, 2023).

[85] *Bray*, 2008 WL 5054695.

[86] *Leader*, 719 F. Supp. 2d at 376.

[87] *Midwest Ath. & Sports All. LLC.*, 2020 U.S. Dist. LEXIS 169770, at *9 (holding plaintiff's submissions did not permit the court to determine whether the work product doctrine applied to litigation funding documents).

[88] *Elenza, Inc. v. Alcon Labs.*, No. N14C-03-185 MMJ CCLD (Del. Super. Ct. June 14, 2016); *In re Int'l Oil Trading Co.*, 548 B.R. at 839; *Charge Injection*, 2015 WL 1540520, at *4-5 (citing *Carlyle*); *Carlyle*, 2015 WL 778846, at *9-10 ("the terms of the final agreement–such as the financing premium or acceptable settlement conditions–could reflect an analysis of the merits of the case"). One court allowed discovery of a funding agreement with redaction, but the court did not cite work-product protection as its rationale for limiting discovery. *See also Queens*, No. 2:14CV53-JRG-RSP (E.D. Tex. Apr. 10, 2015) (ordering, in a cursory opinion, the plaintiff to produce funding agreements with the "dollar amounts" and "percentages" redacted) (excluded from number of decisions eroding work-product because the court did not refer to the work-product doctrine as the basis for its decision).

[89] *Odyssey Wireless*, 2016 U.S. Dist. LEXIS 188611, at *20-24 (allowing discovery of patent valuations, as discussed below); *Morley*, 2015 U.S. Dist. LEXIS 155569, at *10; *Fulton*, 2019 U.S. Dist. LEXIS 209585, at *11 (ordering plaintiff to disclose "all non-mental impressions, fact-based information and documents including any statements provided by Plaintiff directly" to the funder); *Alabama Aircraft Indus. v. Boeing Co.*, No. 2:16-mc-01216-RDP (N.D. Ala. Feb. 9, 2018); *SecurityPoint Holdings, Inc. v. United States*, No. 1:11-CV-00268, 2019 WL 1751194 (Fed. Cl. Apr.

protection for funding documents, but the protection was not absolute for the entirety of the documents. Except for the decisions finding a "substantial need" as discussed below, these decisions do not clearly explain why they chose to permit discovery with redaction instead of completely denying discovery all discovery.

1. Exceptions to Work-Product Protection: Waiver and "Substantial Need"

If funding documents constitute work-product, a defendant can still obtain discovery of the documents if he shows an exception to work-product protection applies. The two main exceptions to work-product protection here are when the disclosure of work-product to a funder (or prospective funder) "substantially increased" the likelihood of the defendant obtaining it, or the defendant has a "substantial need" for these documents. In the cases we found, only the second exception, "substantial need," has led to discovery of funding documents protected by the work-product doctrine.[90] Even if the court allows some discovery under one of these exceptions, the court "must protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of a party's attorney or other representative concerning the litigation."[91]

a) Waiver of Work-Product Protection by Disclosure to Third Party

First, work-product protection may be waived if the materials are disclosed to a third-party. However, unlike the automatic waiver for attorney-client privilege, the "disclosure of a document to third persons does not waive the work-product immunity unless it has substantially increased the opportunities for potential adversaries to obtain the information"[92] Also, the "party asserting waiver has the burden to show that a waiver occurred."[93] "The reason for this difference [between waiver of attorney-client privilege and work-

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16, 2019) (see also ECF Nos. 303, 404). *See also Doe v. Soc'y of Missionaries of Sacred Heart*, 2014 WL 1715376, at *4-5 (The defendant requested documents to support its statute of limitations defense, and the discovery allowed here appears to have been extremely limited, which is why we classified this case in Category One).

[90] *E.g., Gamon Plus*, 2020 WL 18284320, at *2 (providing an analysis of why litigation finance documents may be needed in the context of patent infringement litigation).

[91] Fed. R. Civ. P. 26(b)(3).

[92] 8 Charles Alan Wright & Arthur R. Miller, *Federal Practice & Procedure* § 2024 (3d ed. 2017); Schacknow, *supra* note 35, at 1469.

[93] *Miller*, 17 F. Supp. 3d at 737.

product] is the work-product doctrine's roots in the adversarial process—the point of the protection is not to keep information secret from the world at large but rather to keep it out of the hands of one's adversary in litigation."[94]

Courts have not found work-product protection waived by disclosure to a litigation funder.[95] In fact, the defendants in the *Viamedia* case did not even "argue that Viamedia waived the work-product doctrine by disclosing documents to litigation funding firms under" a non-disclosure agreement.[96] In most of the cases we found, the plaintiff executed a non-disclosure agreement or confidentiality agreement prior to sharing non-deal documents, such as due diligence materials, with a funder. This has reassured courts that disclosures to a funder "did not substantially increase the likelihood that an adversary would come into possession of the materials."[97] Even the lack of a confidentiality agreement, oral or written, "may not be fatal to a finding of non-waiver" because "a prospective funder would hardly advance his business interests by gratuitously" sharing due diligence materials with the defendant.[98]

b) The "Substantial Need" Exception to Work-Product Protection

Second, work-product may be discoverable if the party seeking discovery "shows that it has substantial need for the materials to prepare its case and cannot, without undue hardship, obtain their substantial equivalent by other means."[99] Several courts have found a defendant's substantial need for some information overcame work-product protection for some, but not all, information in funding documents.[100] Both cases limited the discovery to protect the most valuable strategic information.

In re Int'l Oil Trading Co. held that non-deal documents and a funding agreement were both protected work-product.[101] The debtor failed to

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[94] *Viamedia*, 2017 U.S. Dist. LEXIS 101852, at *6.

[95] Glover, *supra* note 2, at 925-26 (citing cases).

[96] *Viamedia*, 2017 U.S. Dist. LEXIS 101852, at *9.

[97] *Mondis*, 2011 WL 1714304, at *3.

[98] *Miller*, 17 F. Supp. 3d at 738.

[99] Fed. R. Civ. P. 26(b)(3).

[100] However, the defendant in *Charge Injection*, for example, failed to demonstrate under Delaware law substantial need for the payment terms in the plaintiff's funding agreement. *Charge Injection*, 2015 WL 1540520, at *5.

[101] *In re Int'l Oil Trading Co.*, 548 B.R. at 837, 838.

demonstrate a substantial need for the non-deal documents, which the court considered “rarely discoverable” opinion work-product.[102] The debtor did, however, successfully demonstrate a substantial need for the funding agreement because the debtor argued it was key to determining whether the creditor transferred some or all of his claim in exchange for financing.[103] Recognizing that “some terms of a litigation funding agreement represent an assessment of risk based on discussions of core opinion work-product of the case,” the court ordered discovery of the funding agreement, but allowed the creditor to redact attorney opinions from it.[104]

Similarly, in *Odyssey Wireless*, the defendants demonstrated a substantial need for the plaintiff’s valuation of patents at issue in the infringement suit because they had no other information on the plaintiff’s valuation of the patents, which was crucial information for their damages case.[105] The court held all the funding documents requested were protected work-product except for the portions on the valuation of the patents.[106]

In conclusion, the work-product doctrine provides strong protection against discovery of funding documents, and it is the most common ground on which courts hold funding documents are not discoverable. There is some concern among academic commentators that “work product protection may not be enough in cases where [a funder] demands confidential information beyond what was created by attorneys” for due diligence, but we did not see that reflected in any of the cases we found.[107] In practice, the work-product doctrine suffices to protect funding documents from discovery because “[r]eputable

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[102] *Id.* at 838.

[103] *Id.* at 838-39.

[104] *Id.* at 839.

[105] *Odyssey Wireless*, 2016 U.S. Dist. LEXIS 188611, at *20-24.

[106] *Id.* This reasoning has been found persuasive by several courts. *Gamon Plus*, 2020 WL 18284320, at *2; *Broadband ITV, Inc. v. OpenTV Inc.*, No. 17-561922, 2019 WL 13170112 (Cal. Super. June 20, 2019); *Electrolysis Prevention Sols., LLC v. Daimler Truck North America LLC*, No. 3:21-171-RJC-WCM, 2023 WL 4750822 (W.D.N.C. July 24, 2023).

[107] Jihyun Yoo, Note, *Protecting Confidential Information Disclosed to Alternative Litigation Finance Entities*, 27 Geo. J. Legal Ethics 1005, 1012 (2014); *accord* Schacknow, *supra* note 35, at 1479 (citing Yoo).

financing providers do not seek information that is confidential due solely to the attorney-client privilege."[108]

IV. EXCEPTIONAL CASES

We identified thirty-four cases in which a court required comprehensive discovery of litigation funding documents. While each of these cases was determined based on its unique circumstances and holds only persuasive influence, there are nine cases among them that stand out as especially significant and warrant further in-depth analysis in this context. These cases have only ever been affirmatively cited on a limited basis.[109] In the first three cases discussed below, the plaintiff was ordered to produce the funding agreement. In the six other of these nine exceptional cases, the courts allowed significant discovery of non-deal documents and some discovery of the funding agreement.

A. Discovery of the Funding Agreement

Discovery of the entire, unredacted funding agreement was allowed in two cases, but neither case analyzed work-product protection for the funding agreement. The third case allowed for discovery of a mostly unredacted funding agreement where the funder was a witness in the case.

In *Gbarabe v. Chevron Corp*., a class action, the court compelled production of the unredacted funding agreement in order to allow the defendant to determine the adequacy of class counsel, who were solo practitioners.[110] In its objection to the discovery, class counsel conceded the relevance of the agreement and did not claim the agreement was privileged.[111] Several aspects of *Gbarabe* distinguish it from the usual discovery dispute over litigation funding documents. First, class counsel did not raise several strong objections to discovery – that the documents were privileged and not relevant. In another earlier class action, for example, the Southern District of New York denied the defendant's discovery request for funding documents because the request was

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[108] Charles Agee, *Guide to Litigation Financing*, at page 7, https://westfleetadvisors.com/wp-content/uploads/2018/11/WA-Guide-to-Litigation-Financing.pdf.

[109] In its attorney-client privilege analysis, *Acceleration Bay* cites *Leader*, but it does not cite any of these litigation funding cases in its section analyzing work-product protection. *Acceleration Bay*, 2018 U.S. Dist. LEXIS 21506, at *5-9.

[110] *Gbarabe v. Chevron Corp.*, No. 14-CV-00173-SI, 2016 WL 4154849, 2016 U.S. Dist. LEXIS 103594, at *4-6 (N.D. Cal. Aug. 5, 2016).

[111] *Id.*

not relevant under Rule 26.[112] Second, class counsel had already voluntarily turned over a redacted version of the funding agreement.[113] Third, class counsel here appeared to be "solo practitioners" who were "dependent on outside funding to prosecute the case."[114] Thus, *Gbarabe* is not representative of most commercial litigation funding cases or even of funding in class actions. No court has cited it yet, and the opinion does not provide a strong basis for future defendants to obtain the same result without the presence of the special facts in *Gbarabe*.[115]

Four years ago, *Cobra Int'l, Inc. v. BCNY Int'l, Inc*. held, without any discussion, that the plaintiff's funding agreement was not privileged and was relevant for the defendant to determine whether the plaintiff transferred ownership of the patent at issue in the infringement suit.[116] The court did not explicitly discuss work-product protection for the funding agreement or whether portions of the agreement could be redacted.[117] Again, we could not find any decision citing *Cobra*. Like *Gbarabe*, its silence on work-product protection suggests it has minimal significance for future cases, unless it appears patent ownership has been transferred.

The Court in *Miller* aptly distinguished cases where the funder will be a witness in the case because financial interest is relevant to a witness's potential bias.[118] For example, in the 2008 *Berger v. Seyfarth Shaw LLP* case, some discovery was permitted into the issue of the funder's potential bias as a witness, but the legal opinions of the plaintiffs' lawyers was still protected.[119] Of course, as in

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[112] *Kaplan*, 2015 U.S. Dist. LEXIS 135031, at *17-18

[113] *Id.* at 4.

[114] *Id.* at 4.

[115] In fact, Judge Illston, who permitted discovery in *Gbarabe*, recently denied a defendant's request for discovery as to litigation funding because it was not relevant to the intellectual property case. *Micron*, 2019 WL 118595, at *2.

[116] *Cobra Int'l, Inc. v. BCNY Int'l, Inc.*, No. 05-61225-CIV, 2013 WL 11311345, 2013 U.S. Dist. LEXIS 190268 (S.D. Fla. Nov. 4, 2013).

[117] *Id.*

[118] *See Miller UK Ltd. v. Caterpillar, Inc.*, 17 F. Supp. 3d 711, 723 (N.D. Ill. 2014) (distinguishing *Berger v. Seyfarth Shaw LLP*).

[119] *Berger v. Seyfarth Shaw LLP*, 2008 WL 4681834, at *2-3 (N.D. Cal. Oct. 22, 2008); *see Yousefi*, 2015 WL 11217257, at *2 (funding from labor union may be relevant to determining credibility and potential bias of labor union witnesses).

Miller, a commercial funder will not be a witness in the typical case, so *Berger* has very limited application in the commercial litigation funding setting.

B. Discovery of Non-Deal Documents, Including Diligence Materials

The court allowed significant discovery of non-deal documents in the following six cases. Five cases of these cases, some of which were decided several years ago, focused on the lack of attorney-client privilege protection. The final case, *Acceleration Bay*, concluded neither attorney-client privilege nor work-product protection applied to non-deal documents after separately analyzing both doctrines.

1. Attorney-Client Privilege Did Not Apply to Non-Deal Documents in Conlon, Cohen, Leader, In re Dealer, and Midwest Ath.

The most influential cases that allowed for significant discovery were among the oldest cases we found, with a few notable exceptions. For example, *Conlon v. Rosa* was a 2004 action in Massachusetts state court against a zoning board.[120] This was not a typical commercial litigation finance case because apparently the plaintiff's tenant funded the zoning challenge to prevent the tenant's business competitor from opening a store nearby.[121] The court ordered production of the funding agreement in redacted form, the plaintiff's lease with its funder, and some related documents.[122] This discovery decision is hard to separate from the specific circumstances of the parties, whose relationship was unlike that typical of the commercial litigation finance industry.

In the following four cases, where courts deemed non-deal documents as subject to discovery without redaction due to their lack of privilege, each court arrived at this determination based on the distinct facts from each case. *Cohen v. Cohen*, a divorce case where the court applied New York law, the plaintiff withdrew her claim that emails with her funder constituted work-product, and the court permitted discovery of emails between the funder and the plaintiff because the communications with the funder waived any applicable attorney-client privilege.[123] The lack of a work-product claim here probably contributed significantly to the court's decision to allow discovery.

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[120] *Conlon*, 2004 Mass. LCR LEXIS 56, at *2.

[121] *Id.* at *2-5.

[122] *Id.* at *12.

[123] *Cohen v. Cohen*, 2015 WL 745712, at *2 (S.D.N.Y. Jan. 30, 2015).

In the 2010 *Leader v. Facebook* decision, the district court judge upheld as not clearly erroneous a magistrate's decision to allow discovery of information shared with a prospective funder. The *Leader* court acknowledged that the law at that time was unsettled on how broadly to define the common interest exception to waiver of the attorney-client privilege.[124] As in *Gbarabe*, *Cobra*, and *Cohen* above, work-product protection was not discussed apart from attorney-client privilege.[125]

Leader has had minimal influence on the subsequent litigation funding discovery disputes we found. A bankruptcy court in Florida expressly distinguished *Leader* and chose not to follow its approach.[126] The District of Delaware cited *Leader* in its analysis of the common interest doctrine in the 2018 *Acceleration Bay* decision, which is discussed below. However, the District of Delaware has not followed *Leader* in cases involving patent monetization consultants, suggesting a possible shift or split within the District on this issue. In *Intellectual Ventures v. Altera*, Judge Stark, who was the then magistrate judge earlier upheld in *Leader*, granted attorney-client privilege protection to some communications with a consultant because a sufficient common interest existed between the plaintiff and the consultant who helped "review, evaluate, and negotiate deals in order to assist [the Plaintiff] in acquiring patents."[127] Likewise, the court in *Walker Digital* found a sufficient common interest existed with a patent monetization company to preserve attorney-client privilege or work-product protection for documents shared with that company.[128] Thus, when considered alongside the many decisions we found since *Leader*, *Leader* was one early decision that does not represent the current position of most courts or even, perhaps, the District of Delaware.

In *In re Dealer*, an antitrust case, communications and documents between the plaintiff and a potential litigation funder were not protected by the attorney-client privilege.[129] However, the court did not have enough information to make a specific ruling on the plaintiff's assertion of the work product doctrine concerning the same communications because the plaintiff did not submit all of

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[124] *Leader Techs., Inc. v. Facebook, Inc.*, 719 F. Supp. 2d 373, 376 (D. Del. 2010).

[125] *See id.*

[126] *See, e.g., In re Int'l Oil Trading Co.*, 548 B.R. at 832-33.

[127] *Intellectual Ventures I LLC v. Altera Corp.*, No. 10-1065-LPS, ECF No. 415, at *12 (D. Del. Jul. 25, 2013).

[128] *Walker Digital v. Google*, No. 11-309-SLR, ECF No. 280, at *2 (D. Del. Feb. 12, 2013).

[129] *In re Dealer*, 2020 U.S. Dist. LEXIS 99767, at *35.

the documents it was withholding for in camera review and the defendants' arguments for why the documents should be disclosed were made very generally.[130]

The court in *Midwest Ath.*, a patent infringement case, held that communications between the plaintiff and a litigation funder were not protected by the attorney-client privilege.[131] The court explained that the common interest exception did not apply because the funder did not acquire an interest in the asserted patents and the relationship between a plaintiff and its litigation funder alone is not enough to create a common interest.[132] Similar to the court in *In re Dealer*, the court noted that plaintiff's submissions did not permit the court to determine whether the work product doctrine applied to litigation funding documents, though its opinion suggested that work product protection would not have applied regardless.[133]

2. Neither Attorney-Client Privilege Nor Work-Product Protection Applied to Non-Deal Documents in Acceleration Bay

Besides the cursory denial of work-product protection in *Leader*, the *Acceleration Bay* decision remains the leading case for instances where a court explicitly denied a plaintiff's claim of work-product protection for funding documents and allowed significant discovery of non-deal documents without redaction. Since *Acceleration Bay*, courts have decided to follow the reasoning of the decision five times.[134] Courts are still unlikely to allow discovery of litigation funding documents after *Acceleration Bay* because it dealt with an unusual application of the law to uncommon facts.[135] In fact, following this decision,

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[130] *Id.* at *47–48.

[131] *Midwest Ath.,* 2020 U.S. LEXIS 169770, at *6–7.

[132] *Id.* at *6.

[133] *Id.* at *9.

[134] In re Dealer Mgmt. Sys. Antitrust Litig., No. 18-C-864, 2020 U.S. Dist. LEXIS 99767 (N.D. Ill. June 8, 2020); Midwest Ath. & Sports All. LLC v. Ricoh USA, Inc., No. 2:19-cv-00514-JDW, 2020 U.S. Dist. LEXIS 169770 (E.D. Pa. Sept. 16, 2020); Gamon Plus, Inc. v. Campbell Soup Co., No. 1:15-cv-08940, 2020 WL 18284320 (N.D. Ill. May 26, 2022); Electrolysis Prevention Solutions, LLC v. Daimler Truck North America LLC, No. 3:21-171-RJC-WCM, 2023 WL 4750822 (W.D.N.C. July 24, 2023); BCBSM, Inc. v. Walgreen Co., No. 1:20-01929, 2023 WL 3737724 (N.D. Ill. May 31, 2023).

[135] This is demonstrated most strongly by the reasoning of *Broadband ITV, Inc. v. OpenTV Inc.*, No. 17-561922, 2019 WL 13170112 (Cal. Super. June 20, 2019). In this case, the court held that the communications between the plaintiff and their litigation funder prior to the date the plaintiff filed the litigation are relevant and should be turned over. However, the court also allowed the

courts have continued to rule for respondents at a ratio of two to one against allowing significant discovery.

To begin with, the facts of *Acceleration Bay* were uncommon because the plaintiff and funder had not yet executed a common interest or non-disclosure agreement during their communications about funding.[136] More importantly, as discussed in Section III above, the court in *Acceleration Bay* did not apply the controlling "because of litigation" test used in the Third Circuit. Instead, it applied the Fifth Circuit's "primary motivating purpose" test for work-product, and it applied that test more narrowly than several prior decisions involving discovery of funding documents.[137] Surprisingly, the court's work-product analysis did not cite to any of the opinions we identified above that specifically address why funding documents qualify as work-product.[138] In addition, the court held that the funding documents did not qualify for attorney-client privilege because their disclosure to the funder breached the required confidentiality. The absence of a common interest between the prospective funder and future plaintiff, as evidenced (in part) by the lack of any written agreement at the time of the communications, prevented the common interest exception from curing that breach.[139] The court's finding of no common interest is consistent with some prior decisions, but there is a split of authority on this issue.[140]

Although there are now numerous decisions on attorney-client privilege and work-product protection for funding documents, the analysis in *Acceleration Bay* suggests courts may still be unfamiliar with the issue.[141] Furthermore,

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plaintiff to assert work product and attorney-client privilege defenses and stated that it will not compel the plaintiff to produce any discovery that falls under those protections. *Id.* at *5-6.

[136] *Acceleration Bay*, 2018 U.S. Dist. LEXIS 21506, at *8. Additional facts specific to this case, as noted in the Special Master's opinion, are that the plaintiff initially claimed there were no responsive documents to produce and did not log the funding communications as privileged. No. 1:16-cv-00454-RGA, ECF No. 327, at *4-7 (Nov. 22, 2017).

[137] *See supra* note 67 and accompanying text (citing cases from the Fifth Circuit and a case from the Eleventh Circuit).

[138] *See Acceleration Bay*, 2018 U.S. Dist. LEXIS 21506, at *5-6.

[139] *Id.* at *7-9 (citing *Leader* to support the conclusion that there was no common legal interest).

[140] *See supra* note 40 and accompanying text.

[141] At least one district court has distinguished the decision in *Acceleration Bay*, though it did so in the context of a relevancy analysis. In *United Access Techs., LLC*, the District of Delaware rejected a defendant's argument that under the decision in *Acceleration Bay* "communications

plaintiffs should execute a common interest and non-disclosure agreement with funders before sharing confidential information.[142]

V. CONCLUSION

Particularly over the past five years, there has been a significant uptick in the amount of court decisions regarding the discoverability of litigation funding documents. These rulings have generally been decided in favor of litigation funders and respondents who are trying to preserve the confidentiality of their litigation funding arrangements. Additionally, there has been a trend where the denial of these discovery requests is predominately attributed to claims that the litigation funding documents lacks relevance to a claim or defense. Additionally, numerous courts have held that litigation funding is protected by either attorney client privilege or, more commonly, the work-product doctrine.

We find no compelling rationale for courts to shift their stance and abandon the reasoning that currently protects litigation funding documents from being discovered. This is because courts that opt to permit the discovery of such documents have distinct and discernible reasons for their departure from the prevailing approach. For the foreseeable future, we imagine that courts will continue to align with the precedent set by *Miller* and its progeny and protect litigation funding documents from discovery.

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with prospective sources of funding, as well as subsequent litigation updates to eventual funders, are 'relevant to central issues like [patent] validity and infringement, valuation, damages, royalty rates, and whether plaintiff is an operating company.'" *United Access Techs., LLC*, 2020 U.S. Dist. LEXIS 103532, at *4. The court held that *Acceleration Bay* "does not hold (as no case should) that such materials are always relevant, without any consideration of additional factors." *Id.*

[142] In a later opinion, Judge Andrews advised against broadly reading his *Acceleration Bay* decision, explaining that a written agreement is one factor in finding whether parties share a common legal interest. *TC Tech. LLC v. Sprint Corp.*, 16-CV-153-RGA, 2018 WL 6584122, at *5 (D. Del. Dec. 13, 2018). District courts have also noted that confidentiality agreements bolster one's argument against waiver of work-product protection. *See Impact Engine, Inc.*, 2020 U.S. Dist. LEXIS 194517, at *3 (holding the fact that the documents contained confidentiality provisions and that the funder had a common interest to that of the attorney or client weighed in favor of not imposing a waiver).

APPENDIX A

Decisions Concerning Discoverability of Litigation Funding Agreements and Documents Related to Litigation Funding

(Through August 2023)

Medtronic Sofamor Danek, Inc. v. Michelson, No. 01-2373, 2003 U.S. Dist. LEXIS 25198 (W.D. Tenn. Nov. 6, 2003).

Conlon v. Rosa, Nos. 295907, 295932, 2004 Mass. LCR LEXIS 56, 2004 WL 1627337 (Mass. Land Ct. July 21, 2004).

Berger v. Seyfarth Shaw, LLP, et al., 2008 U.S. Dist. LEXIS 88811, 2008 WL 4681834 (N.D. Cal. Oct. 22, 2008).

Bray & Gillespie Mgmt. LLC v. Lexington Ins. Co., No. 6:07CV222-ORL-35KRS, 2008 WL 5054695 (M.D. Fla. Nov. 17, 2008).

Rembrandt Techs., L.P. v. Harris Corp., No. 07C-09-059-JRS, 2009 WL 402332, 2009 Del. Super. LEXIS 46 (Del. Super. Ct. Feb. 12, 2009).

Leader Techs., Inc. v. Facebook, Inc., 719 F. Supp. 2d 373, 376 (D. Del. 2010).

Mondis Tech., Ltd. v. LG Elecs., Inc., No. 2:07-CV-565-TJW-CE, 2011 WL 1714304 (E.D. Tex. May 4, 2011).

SSL Servs., LLC v. Citrix Sys., No. 2:08-cv-158-JRG, 2012 U.S. Dist. LEXIS 198173 (E.D. Tex. May 23, 2012).

Devon It, Inc. v. IBM Corp., No. CIV.A. 10-2899, 2012 WL 4748160 (E.D. Pa. Sept. 27, 2012).

Walker Digital v. Google, Civ. No. 11-309-SLR (D. Del. Feb. 12, 2013).

Cabrera v 1279 Morris LLC, 2012 WL 5418611 (N.Y. Sup. Ct. 2013).

Intel Corp. v. Prot. Captial LLC, No. 13cv1685 GPC (NLS), 2013 U.S. Dist. LEXIS 201883 (S.D. Cal. Oct. 2, 2013)

Cobra Int'l, Inc. v. BCNY Int'l, Inc., No. 05-61225-CIV, 2013 WL 11311345, 2013 U.S. Dist. LEXIS 190268 (S.D. Fla. Nov. 4, 2013).

Miller UK Ltd. v. Caterpillar, Inc., 17 F. Supp. 3d 711 (N.D. Ill. 2014).

Doe v. Soc'y of Missionaries of Sacred Heart, No. 11-CV-02518, 2014 WL 1715376 (N.D. Ill. May 1, 2014).

The Abi Jaoudi and Azar Trading Corp. v. CIGNA Worldwide Ins. Co., No. 2:91-cv-0785 (E.D. Pa. Jul. 17, 2014).

Cohen v. Cohen, No. 09 CIV. 10230 LAP, 2015 WL 745712 (S.D.N.Y. Jan. 30, 2015).

Carlyle Inv. Mgmt. L.L.C. v. Moonmouth Co. S.A., No. CV 7841-VCP, 2015 WL 778846 (Del. Ch. Feb. 24, 2015).

Charge Injection Techs., Inc. v. E.I. DuPont De Nemours & Co., No. CV 07C-12-134-JRJ, 2015 WL 1540520 (Del. Super. Ct. Mar. 31, 2015).

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APPENDIX B

Decisions Concerning Discoverability of Litigation Funding Agreements and Documents Related to Litigation Funding – Organized by Jurisdiction

(Through August 2023)

STATE COURTS (AND FEDERAL COURTS APPLYING STATE LAW)

Alabama

Alabama Aircraft Indus. v. Boeing Co., No. 2:16-mc-01216-RDP (N.D. Ala. Feb. 9, 2018).

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Mandatory Disclosure Rules for Dispute Financing

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White Paper on Mandatory Disclosure in Third-Party Litigation Finance

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ABSTRACT

Third-party litigation finance (TPLF), in which non-parties in litigation give parties money in exchange for a beneficial interest in the outcome of the litigation, has increased rapidly in the United States over the past twenty years. Different markets have emerged involving consumer and corporate plaintiffs, and TPLF has also been adapted for use in mass litigation (class actions and multi-district litigation). As a result, observers and courts have proposed that TPLF be disclosed in litigation in a submission to the court. This paper reviews the arguments for disclosure (including the different ways in which disclosure could occur and the costs and benefits of disclosure). This paper argues that many of the arguments for disclosure are unproven or speculative. It argues that the costs to plaintiffs of disclosure may be high and that the benefits are likely to be low. It concludes that two limited types of disclosure may be justified, notwithstanding its conclusion that broad TPLF disclosure imposes unjustified costs on the civil justice system.

I. INTRODUCTION

A. DEFINING THIRD-PARTY LITIGATION FINANCE

Third-party litigation finance (TPLF) does not have a single meaning.[1] Most frequently, TPLF is used to refer to financial support of litigation by a stranger in exchange for a share of the proceeds generated by that litigation.[2] TPLF under this description is identical to the old common law practice of champerty.[3] However, TPLF may also refer to practices that are related, but not identical, to champerty.

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[1] *See* Victoria A. Shannon, *Harmonizing Third-Party Litigation Funding Regulation*, 36 CARDOZO L. REV. 861, 863 n.3 (2015) (discussing range of transactions included in definition of TPLF).

[2] Third-party litigation funding is the commercial financing of an individual or portfolio of lawsuits by a person or entity that is not a party to the litigation itself. Although contingency fees and insurance coverage also constitute forms of funding by non-parties, we use the term TPLF in this paper to connote funding provided by firms on a non-recourse basis, in exchange for a share of the settlement or judgment proceeds. 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, 111-12 (2013); *see also* Miller UK Ltd. v. Caterpillar, Inc., 17 F. Supp. 3d 711, 718 (N.D. Ill. 2014) (TPLF is "where money is advanced to a plaintiff, and the funder takes an agreed upon cut of the winnings. If the plaintiff loses the case, the funder may get nothing.").

[3] *See* Lazar Emanuel, *Overall View of Litigation Funding Industry*, N.Y. LEGAL ETHICS REP., Feb. 1, 2011, http://www.newyorklegalethics.com/an-overall-view-of-the-litigation-funding-industry

Financial support of litigation by a stranger on a gratuitous basis, not in exchange for future proceeds and not motivated by a desire for profit, is maintenance.[4] Maintenance, although rare, is a form of TPLF.[5]

Some observers of the TPLF market use the term to refer to transactions between nonlawyers and lawyers where the nonlawyer advances capital to the lawyer in exchange for a future payment based on the lawyer's receipt of a fee, if and when that occurs.[6] This form of TPLF is neither champerty nor maintenance, because the third-party funder is not providing support directly to a party in litigation. Many commentators caution against treating capital advances to lawyers as identical to third-party investment in lawsuit through direct payments to litigants.[7] Although the legal and economic circumstances of capital advances to lawyers are a non-standard form of TPLF, they will be covered in this White Paper, although distinguished from standard TPLF, which involves a transaction with a party, not their lawyer.[8]

B. TPLF MARKETS

TPLF, when it is limited to champerty, is divided in the United States between the commercial and the consumer sectors.[9] In the former, funding is provided to a highly sophisticated litigant, usually a corporation, to help pay for the attorneys and their costs in a commercial dispute.[10] In the latter, funding is provided directly to individuals, most of whom have never engaged previously in litigation.

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[4] *See* Max Radin, *Maintenance by Champerty*, 24 CALIF. L. REV. 48 (1935).

[5] *See* Anthony J. Sebok, *The Inauthentic Claim*, 64 VAND. L. REV. 61, 72 (2011).

[6] *See* Lisa Rickard & Mark Behrens, *Third-Party Litigation Funding In U.S. Enters Mainstream, Leading To Calls For Reform*, FINANCIER WORLDWIDE, November 2016, https://www.financierworldwide.com/third-party-litigation-funding-in-us-enters-mainstream-leading-to-calls-for-reform ("Third-party litigation funders front money to plaintiffs' law firms in exchange for an agreed-upon cut of any settlement or money judgment."); Radek Goral, *The Law of Interest Versus the Interest of Law, or on Lending to Law Firms*, 29 GEO. J. LEGAL ETHICS 253, 256 (2016) (arguing that capital advances to law firms can be a form of TPLF).

[7] *See e.g.,* Nora Freeman Engstrom, *Lawyer Lending: Costs and Consequences*, 63 DEPAUL L. REV. 377, 383 (2014) (capital advances to lawyers are "more different than alike" other forms of TPLF); Shannon, *supra* note 1 at 863 n.3.

[8] For a complete discussion of capital advances to lawyers, *see* Anthony J. Sebok, *Selling Unearned Attorneys' Fees*, 2018 ILL. L. REV. 1207.

[9] For a comprehensive review of the TPLF market, *see* Steven Garber, ALTERNATIVE LITIGATION FINANCING IN THE UNITED STATES: ISSUES, KNOWNS, AND UNKNOWNS, RAND Institute for Civil Justice, Law, Finance, and Capital Markets Program Occasional Paper (2010).

[10] *Ibid* at 13.

Importantly, consumer TPLF allows money to flow directly to the litigant, providing an important source of financial support during the pendency of litigation.[11] Funding contracts differ in type between the two sectors. Commercial TPLF usually pays the funder a percentage of the litigation proceeds upon resolution of the litigation.[12] In contrast, in consumer TPLF, the funder receives a payment based on monthly or semi-annual interest charges determined by the length of time to the resolution of the litigation.[13]

When TPLF is extended to include direct funding of lawyers, the form of the transactions are hard to generalize, because there is very little publicly available information about third-party funding of lawyers. The market seems to be divided into three types of transactions. First, there are transactions between funders who advance capital in exchange for a security interest in the unearned fee of a single case or a small number of identifiable cases.[14] Second, there are transactions between larger commercial funders and law firms in which capital advances are

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[11] *Id.* at 9. Wellfleet Advisors, a U.S. commercial TPLF consultancy, published a review of the market in 2019. It estimated that in 2019, "$2.3 billion was committed to commercial litigation finance transactions with a nexus to the U.S." Charles Agee and Gretchen Lowe, LITIG. FIN. BUYER'S GUIDE (Westfleet Advisors 2019) (https://assets.website-files.com/5d3219df242257de8146924c/5dd813e3cd97761 c9b70e0a0_Westfleet%20Buyers%20Guide%202019-11-17.pdf)

[12] In commercial litigation finance contract "the financier provides immediate capital to prosecute the case in exchange for a percentage of the future recovery." Joanna M. Shepherd & Judd E. Stone II, *Economic Conundrums in Search of a Solution: The Functions of Third-Party Litigation Finance*, 47 ARIZ. ST. L.J. 919, 937 (2015). But there is no "one size fits all" commercial litigation finance contract. Commercial funding is diverse and includes many different types of products. *See, e.g.* Maya Steinitz, *The Litigation Finance Contract*, 54 WM. & MARY L. REV. 455 (2012) *and see* Shepherd & Stone, *Economic Conundrums in Search of a Solution* at 941-42 (on the use of "first money out" and "waterfall" payment structures).

[13] *See* Garber, *supra* note 9 at 9.

[14] The following courts have upheld the assignment of a security interest in an unearned contingent fee in exchange for a capital advance. Hamilton Capital VII, LLC v. Khorrami, LLP, 2015 NY Slip Op 51199(U), 48 Misc. 3d 1223(A), 22 N.Y.S.3d 137 (Sup. Ct.); Lawsuit Funding, LLC v. Lessoff, 2013 WL 6409971 (NY Sup. Crt. 2013); Kelly, Grossman & Flanagan, LLP v Quick Cash, Inc., 35 Misc. 3d 1205(A) (N.Y. Sup. Ct. 2012); PNC Bank v. Berg, No. 94C-09-208-WTQ, 1997 Del. Super. LEXIS 19, at *27 (Super. Ct. Jan. 31, 1997). In *Lessoff*, for example, the agreement "called for Plaintiffs to receive a portion of the contingent legal fee that Defendants were expected to receive if five specifically named lawsuits were adjudicated in favor of Defendants' clients." *Lessoff* at *2. In addition, in *Counsel F in. Servs. v. Leibowitz*, 2013 Tex. App. LEXIS 9252 (13th Dist. Ct. App.), the court recognized contract rights in an unearned contingent fee defined by the application of an interest rate to a fixed sum.

secured by "portfolios" of cases.[15] Third, there have been reports of TPLF provided to a law firm seeking to be appointed lead counsel in a class action.[16]

II. ARGUMENTS FOR DISCLOSURE

A. INTRODUCTION

It is crucial to distinguish at the outset the difference between proposals for disclosure of TPLF, in their various forms, and other proposals concerning the regulation or elimination of TPLF. Disclosure of TPLF relates to mandatory requirements concerning information about TPLF. The range of other proposals concerning the regulation and elimination of TPLF is vast, and beyond the scope of this White Paper. It should be noted, in passing, that some states prohibit all TPLF and some states have imposed limitations on only consumer TPLF, either as a matter of judicial interpretation or legislative enactment.[17] Some of the same groups that have called for disclosure have also called for other forms of regulation (or elimination) of TPLF.[18]

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[15] *See Bentham IMF Unveils New Portfolio Model for Litigation Funding,* Bentham IMF (Nov. 16, 2015), https://www.benthamimf.com/docs/default-source/default-document-library/portfolioannouncementclean.pdf?sfvrsn=2; *Burford Capital 2017 Annual Report* at 7, http://www.burfordcapital.com/wp-content/uploads/2018/03/BUR-28711-Annual-Report-2017-web.pdf; *See* Victoria Shannon Sahani, *Reshaping Third-Party Funding*, 91 TUL. L. REV. 405, 409-10 (2017) (on portfolio TPLF).

[16] *See* Gbarabe v. Chevron Corp., No. 14-cv-00173, 2016 WL 4154849 (N.D. Cal. Aug. 5, 2016).

[17] *See* Prospect Funding Partners, LLC v. Williams, No. 27-CV-13-8745, 2014 Minn. Dist. LEXIS 2 (Dist. Ct. Hennepin County, Minn., May 5, 2014) (noting Minnesota's long-standing prohibition on TPLF). Oasis Legal Fin. Grp., LLC v. Coffman, 361 P.3d 400 (Colo. 2015) (placing consumer TPLF contracts under state consumer credit law). Four states have passed legislative limits on the cost of consumer TPLF: Ark. SB 882 (2015) (to be codified at Ark. Code § 4-57-109(a)(2)) (effective Apr. 1, 2015) (maximum rate of 17% per annum); Ind. Code 24-4.5-3-202 (effective July 1, 2016) (maximum rate of 36%); Tenn. Code Ann. § 47-51-101 et seq. (effective July 1, 2015) (maximum rate of 36% per year for a maximum of three years); and W. Va. Code §§ 46A-6N-9(a) (maximum rate of 18% per year) (effective June 5, 2019).

[18] U.S. CHAMBER INST. FOR LEGAL REFORM, SELLING LAWSUITS, BUYING TROUBLE: THIRD-PARTY LITIGATION FUNDING IN THE UNITED STATES (2009), http://www.instituteforlegalreform.com/research/selling-lawsuits-buying-trouble-the-emerging-world-of-third-party-litigation-financing-in-the-united-states

B. ARGUMENTS FOR DISCLOSURE IN COMMERCIAL TPLF

Arguments for disclosure of TPLF have arisen in two waves. In the first wave, defendants have attempted to obtain documents related to TPLF from adverse parties in litigation.[19] Typical of such a request was that of the defendant in *Miller UK Ltd. v. Caterpillar, Inc.*, who asked for "the actual contract with Miller's [the plaintiff] funder and those documents provided by Miller to it and any other third-party lender from which Miller sought funding for this case."[20] The reasons for requesting the documents were that they would be relevant to helping the defendant determine whether it had a defense of champerty under state law, who was the real party in interest under Rule 17(a) of the Federal Rules of Civil Procedure ("FRCP"), and that the documents contained material relevant to the underlying issue of liability and damages.[21] Most courts that have been asked to enforce discovery motions to disclose TPLF-related documents have rejected the requests on the ground that the documents contain attorney work product, and the conditions for waiver of work product have not been satisfied per FRCP Rule 26(b)(3)(B).[22] On a number of occasions, courts have rejected discovery of TPLF-related documents on the ground that the requested documents were not relevant to the underlying litigation.[23]

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[19] *See* Grace M. Giesel, *Alternative Litigation Finance and the Work-Product Doctrine*, 47 WAKE FOREST L. REV. 1083 (2012); Grace M. Giesel, *Alternative Litigation Finance and The Attorney-Client Privilege*, 92 DENV. U.L. REV. 95 (2014).

[20] 17 F. Supp. 3d 711, 713 (N.D. Ill. 2014).

[21] *Ibid.* at 719 and 739–40.

[22] *Id*. at 736 ("Because the work-product doctrine serves to protect an attorney's work product from falling into the hands of an adversary, a disclosure to a third party does not automatically waive work-product protection."); *and see* Ala. Aircraft Indus. v. Boeing Co., No. 2:16-mc-01216-RDP (N.D. Ala., Feb. 9, 2018); Lambeth Magnetic Structures, LLC v. Seagate Tech. (US) Holdings, Inc., 2017 U.S. Dist. LEXIS 215773 (W.D. Pa. Dec. 19, 2017); Viamedia, Inc. v. Comcast Corp., 2017 U.S. Dist. LEXIS 101852 (N.D. Ill. June 30, 2017); Odyssey Wireless, Inc. v. Samsung Electronics Co., Ltd, 2016 U.S. Dist. LEXIS 188611, (S.D. Cal. Sept. 20, 2016); United States v. Homeward Residential, Inc.,2016 U.S. Dist. LEXIS (E.D. Tex. Mar. 15, 2016); United States v. Ocwen Loan Serv., LLC, 2016 U.S. Dist. LEXIS 32967, (E.D. Tex. Mar. 15, 2016); *In re*: Int'l Oil Trading Co., LLC, 548 B.R. 825, 832 (Bankr. S.D. Fla. 2016; Charge Injection Techs., Inc. v. E.I. Dupont De Nemours & Co., 2015 Del. Super. LEXIS 166 (Super. Ct. Mar. 31, 2015); Carlyle Inv. Mgmt. L.L.C. v. Moonmouth Co. S.A., 2015 Del. Ch. LEXIS 42 (Feb. 24, 2015); Devon IT, Inc. v. IBM Corp., 2012 U.S. Dist. LEXIS 166749 (E.D. Pa. Sep. 27, 2012); *Mondis Tech., Ltd. v. LG Elecs., Inc.,* 2011 U.S. Dist. LEXIS 47807 (E.D. Tex. May 4, 2011); *but see* Acceleration Bay LLC v. Activision Blizzard, Inc., 2018 U.S. Dist. LEXIS 21506 (D. Del. Feb. 9, 2018) (rejecting the argument that TPLF documents were protected under the work product doctrine).

[23] *See* Benitez v. Lopez, 2019 U.S. Dist. LEXIS 64532, at *2-3 (E.D.N.Y. Mar. 14, 2019) ("In this case, the financial backing of a litigation funder is as irrelevant to credibility as the Plaintiff's personal financial wealth, credit history, or indebtedness. That a person has received litigation funding does not assist the

The second wave has come in the form of proposals to amend state and federal law. Typical of these proposals is the following, which was proposed by the U.S. Chamber Institute for Legal Reform to FRCP 26(a)(1)(A) in 2017:

> 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.[24]

This proposal is identical to one which the U.S. Chamber proposed in 2014 and 2016.[25] A nearly identical proposal was recently passed in Wisconsin:

Third-party agreements. Except as otherwise stipulated or ordered by the court, a party shall, 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, by settlement, judgment, or otherwise.[26]

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factfinder in determining whether or not the witness is telling the truth."); In re Valsartan N-Nitrosodimethylamine (NDMA) Contamination Prods. Liab. Litig., 2019 U.S. Dist. LEXIS 160051, at *29 (D.N.J. Sep. 18, 2019) ("The Court finds that litigation funding is irrelevant to the claims and defenses in the case and, therefore, plaintiffs' litigation funding is not discoverable."); MLC Intellectual Property LLC v. Micron Technology, Inc, 2019 U.S. Dist. LEXIS 2745 at *2 (N.D. Ca. Jan. 7, 2019) ("The Court concludes that [defendant] is not entitled to the discovery it seeks because it is not relevant."); Yousefi v. Delta Electric Motors, Inc, 2015 U.S. Dist. LEXIS 180843, at *2 (W.D. Wash. May 11, 2015) ("Whether plaintiff is funding this litigation through savings, insurance proceeds, a kickstarter campaign, or contributions from [a] union is not relevant to any claim or defense at issue."). *and see* Miller, 17 F. Supp. 3d at 723.

[24] *See Letter from U.S. Chamber Institute for Legal Reform et al. 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, Appendix B, http://www.uscourts.gov/sites/default/files/17-cv-o- suggestion_ilr_et_al_0.pdf ("Chamber Letter").

[25] *See Report to the Standing Committee of the Advisory Committee on Civil Rules*, Dec. 6, 2017 at 247 ("Standing Committee Report").

[26] 2017 Assembly Bill 773 ("SECTION 12. 804.01 (2) (bg) is created to read"). The bill was signed into law on Apr. 2, 2018.

The proposal to amend Rule 26 has been explained in materials from various tort reform organizations which are publicly available. The letters from the U.S. Chamber and the Request for Rulemaking to the Advisory Committee on Civil Rules from Lawyers for Civil Justice raise multiple concerns about TPLF.[27] These sources suggest that disclosure would protect "the integrity of the adversarial process"[28] in the following ways:

1. Expose violations of laws against champerty, where they exist[29];
2. Expose violations of the prohibition against fee-splitting between lawyers and non-lawyers[30];
3. Expose agreements which create impermissible conflicts of interest between lawyers, funders and clients[31];
4. Expose conflicts of interests between judges and funders[32];
5. Expose efforts by funders to control litigation[33];
6. Expose contract terms that might "undermine" settlement[34];
7. Allow judges to weigh the resources available to parties to determine discovery[35];
8. Allow judges to know who the real party in interest is, if sanctions are imposed[36];

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[27] *See Chamber Letter and Request for Rulemaking to the Advisory Committee On Civil Rules*, Aug. 10, 2017, from Lawyers for Civil Justice, http://www.lfcj.com/uploads/1/1/2/0/112061707/lcj_request_for_rulemaking_concerning_mdl_cases_8-10-17.pdf ("Request for Rulemaking).

[28] *See* Chamber Letter at 11.

[29] *Ibid*.

[30] *Id.* at 13.

[31] *Id.* at 14.

[32] *Id.* at 15.

[33] *Id.* at 16.

[34] *Id.* at 18.

[35] *Id.* at 19. This is the "proportionality" test under FRCP Rule 26. *See* Hon. Elizabeth D. Laporte & Jonathan M. Redgrave, *A Practical Guide to Achieving Proportionality Under New Federal Rule of Civil Procedure 26*, 2015 FED. CTS. L. REV. 19 (2015). The irony of defendants raising this argument will be explored below at text accompanying n.85.

[36] *Id.* at 19.

9. Allow judges to know whether a third party in addition to plaintiffs are interested in the result of a class or mass action[37];

10. Allow "parity of financial disclosure" similar to Rule 26's requirement that parties (usually defendants) disclose the existence and terms of liability insurance[38];

11. Allow the public to know whether a third party with a non-economic, social or political motive is using a party in litigation; in other words, to make it harder for someone like Peter Thiel to fund a lawsuit against a defendant like Gawker Media.[39]

As the Standing Committee of the Advisory Committee on Civil Rules noted in a report, some of the putative justifications for disclosure are moot if the problem that they are supposed to cure does not exist in practice, such as the problem that TPLF allows funders to control litigation (something funders deny) or undermine settlement (again, something funders deny).[40] Other justifications may be possible, such as conflict of interests between judges and funders where a judge owns shares in a commercial funder, or the risk that a TPLF contract is in violation of state law, but then there is a question of costs versus benefits — whether a rule that requires compulsory disclosure is worth the costs that it would impose.[41]

C. ARGUMENTS FOR DISCLOSURE IN CONSUMER TPLF

The arguments reviewed above for disclosure have been raised primarily by critics of commercial TPLF and have received responses from primarily commercial funders such as Burford and Bentham. Consumer TPLF would be affected by the disclosure rules proposed for Rule 26, and will be affected by the new disclosure rule adopted in Wisconsin, but the consumer TPLF companies have not expressed much of an opinion about disclosure. This may be for a number of reasons, the

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[37] *Id.* at 20.

[38] *Id.* at 22. Many of these points are repeated in the Request for Rulemaking at 9–10.

[39] *See* Andrew Ross Sorkin, *Peter Thiel Is Said to Bankroll Hulk Hogan's Suit Against Gawker*, N.Y. TIMES, May 25, 2016 at B3. According to sources present at the debate of the Wisconsin bill, the "Peter Thiel" problem was raised by proponents of the bill to convince some skeptics.

[40] Standing Committee Report at 248 ("Third-party funders meet [some of] these arguments by direct denial. None of them . . . are true.").

[41] *Ibid* at 250.

most significant that consumer TPLF firms are much more concerned with other changes to the law of TPLF that are separate from proposals concerning disclosure. Consumer TPLF companies are concerned with changes to the law that would treat TPLF contracts with consumers as loans or as advances subject to limits similar to those imposed by usury law or other consumer credit laws.[42] The automatic disclosure requirement adopted by Wisconsin will apply to a $2,500 consumer TPLF contract as well as a $2 million commercial TPLF contract, but it seems that this extra burden was not of great concern to the consumer TPLF companies. Their main concern was to remove from the bill language which would have defined TPLF as "lending," which might have brought their contracts within Wisconsin's usury law.[43] They were successful.[44] In West Virginia, the 2019 law that caps the price of consumer TPLF at 18% per annum also requires a mandatory disclosure; again, it appears that it is the price cap, not the mandatory disclosure, that led the consumer TPLF companies to oppose the legislation.[45] One reason that consumer TPLF firms may not be concerned with disclosure proposals is that the existence of TPLF may be of little or no interest to the adverse party, since TPLF contracts are based on templates and their terms reveal nothing about the underlying case or any lawyer's work product.[46]

Disclosure in the context of consumer TPLF can mean more than allowing adverse parties to know about the existence of a funding agreement and the content of that agreement. It can mean regulatory requirements that funders

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[42] *See, e.g.*, Jenna Wims Hashway, *Litigation Loansharks: A History of Litigation Lending and a Proposal to Bring Litigation Advances Within the Protection of Usury Laws*, 17 ROGER WILLIAMS U. L. REV. 750 (2012). The adoption of usury-type regulation has caused consumer TPLF firms to leave Colorado and Tennessee, states where they were once active. *See, e.g.,* Andrew G. Simpson, *Litigation Financing Firm Exits Tennessee As New Law Goes Into Effect*, INS. J., July 3, 2014, http://www.insurancejournal.com/news/southeast/2014/07/03/333772.htm

[43] John Breslin, *Judiciary Committee Approves Amended Legal Reform Bill In Wisconsin*, LEGALNEWS-LINE, Feb. 21, 2018, https://legalnewsline.com/stories/511348497-judiciary-committee-approves-amended-legal-reform-bill-in-wisconsin

[44] *Civil Justice Reform Passes Assembly, Held Up in the Senate*, WIS. MANUFACTURERS & COM., Mar. 1, 2018, https://www.wmc.org/uncategorized/civil-justice-reform-passes-assembly-held-up-in-the-senate/

[45] W.VA. CODE §46A-6N-6 (Third-party agreements) ("Except as otherwise stipulated or ordered by the court, a party shall, without awaiting a discovery request, provide to the other parties any agreement under which any litigation financier, 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.").

[46] Further, given that consumer TPLF concerns cases that rarely go to trial (or even progress into significant discovery), it may be that, to the extent that funders are concerned that judges may respond to the existence of funding, the risk of judicial notice of consumer TPLF is extremely low.

provide information to the consumer. It can also mean regulatory requirements that funders provide information to a public agency (either state or federal).

On February 17, 2005, the Attorney General of the State of New York and nine New York-based consumer TPLF firms entered into an "Assurance of Discontinuance" agreement that resulted from negotiations between the Attorney General and the LFCs.[47] The main purpose of the N.Y. Agreement was to put into place certain disclosure requirements that TPLF firms would have to provide to consumers in the State of New York. The N.Y. Agreement imposed nine requirements, modeled after standardized credit card and mortgage applications. The key requirements were a clear statement of the financial terms of the agreement, including a statement of (a) the total amount being advanced; (b) an itemization of one-time fees broken out item by item (e.g., application, processing, attorney review, broker, etc.); (c) the annual percentage interest rate charged and how often interest compounds; and (d) the total amount the borrower will repay broken out by six-month intervals and carried forward to thirty-six months, including all fees and the minimum payment amount, as well as a five-business-day period to cancel the contract without suffering a penalty. It does not impose an upper limit on how much the funder can charge in interest, fees, or other costs.

Since 2005, the two major consumer TPLF trade organizations have adopted voluntarily codes of conduct that parallel the N.Y. Agreement.[48] Five states, Maine, Nebraska, Ohio, Oklahoma, and Vermont, have adopted disclosure laws that, with some variation, endeavor to provide consumers protection through forcing TPLF firms to provide information similar to that disclosed under the N.Y. Agreement.[49] Indiana has adopted a law with disclosure requirements similar to those of the N.Y. Agreement, but since it also has a cap on the price of consumer TPLF, the

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[47] BUREAU OF CONSUMER FRAUDS AND PROTECTION, ATTORNEY GEN. OF THE STATE OF N.Y., ASSURANCE OF DISCONTINUANCE PURSUANT TO EXECUTIVE LAW § 63(15) 4-7 (2005) ("N.Y. Agreement"), available at https://www.mighty.com/blog/nyattorneygeneralplaintifffundingagreement

[48] *See The ALFA Code of Conduct*, AM. LEGAL FIN. ASS'N, https://americanlegalfin.com/alfa-code-of-conduct/ and *Industry Best Practices*, ALLIANCE FOR RESPONSIBLE CONSUMER LEGAL FUNDING, http://arclegalfunding.org/industry-best-practices/

[49] *See* ME. REV. STAT. ANN. tit. 9-A, § 12-101 (effective Jan. 1, 2008); NEB. REV. STAT. § 25-3302(1), (4) (effective Apr. 13, 2010); OHIO REV. CODE ANN. § 1349.55(A)(1) (effective Aug. 27, 2008); OKLA. STAT. tit. § 14A-3-801(6) (effective May 29, 2013) and 8 VT. STAT. ANN. tit.§§ 2251–2260 (effective July 1, 2016). Some of these legislative schemes also protect the consumer by forbidding certain substantive contract terms, such as prohibiting compounding interest monthly (e.g., Maine and Nebraska) or prohibiting mandatory arbitration (Vermont).

legislation is not seen primarily as a disclosure law, and it was only grudgingly endorsed by one of the two TPLF trade organizations.[50]

In addition to forcing a clear statement of existing contract terms, which is what the N.Y. Agreement does, disclosure could also include additional information not contained in the contract, and it could include disclosure to third parties other than the consumer or the defendant, such as a state or federal agency tasked with collecting information. Up to now, proposals under the heading of "disclosure," which have been promoted mostly by consumer TPLF trade groups, have focused on making existing contract terms as clear as possible. For example, the proposed legislation currently favored by ALFA in New York would require "an itemization of one-time charges; the maximum total amount to be assigned by the consumer to the company, including the funded amount and all charges; and a payment schedule to include the funded amount and charges, listing all dates and the amount due" at the end of six-month periods.[51]

Recent empirical research into the behavior of the consumer TPLF suggests that, while the price of consumer TPLF is not as high as its critics have suggested, the market is extremely opaque and consumer may not be receiving the same final price for the sale of their asset.[52] Disclosure of whether consumer TPLF companies have adjusted the final price charged to the consumer after the resolution of the consumer's lawsuit, and the actual average price charged to consumers, is something that consumers and regulators may benefit from knowing. Mandatory disclosure of this data is another form of disclosure, different from either the disclosure to adverse parties urged in the context of commercial TPLF and

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[50] IND. CODE 24-4.5-3-202 (effective July 1, 2016) (maximum rate of 36%) *and see* Victor Li, *Indiana and Vermont Regulate Consumer Litigation Funding,* ABA JOURNAL, July 7, 2016, http://www.abajournal.com/news/article/indiana_and_vermont_regulate_consumer_litigation_funding (on ARC's views of Indiana TPLF law)

[51] *See* Consumer Litigation Funding Act, S.B. S3651, 2019 Leg., Reg. Sess. (N.Y. 2019), introduced by Sens. Comrie and Ranzenhofer, February 11, 2019 *at* §899-GGG ("Disclosures"). The proposed legislation would also require consumer TPLF firms to report the "number of consumer litigation fundings" by each firm; a "summation of funded amounts"; the "annual percentage charged to each consumer where repayment was made" and these figures would be made available to the public. *Ibid* at 899-LLL ("Reporting").

[52] *See* Ronen Avraham & Anthony J. Sebok, *An Empirical Investigation of Third Party Consumer Litigation Funding*, 104 CORNELL L. REV. 1133 (2018) *and* Ronen Avraham & Anthony J. Sebok, *Americans Should Have The Proper Protections When Bringing Lawsuits*, THE HILL, Mar. 29, 2018, http://thehill.com/opinion/judiciary/380891-americans-should-have-the-proper-protections-when-bringing-lawsuits

disclosure of contract terms which has been the primary focus of consumer TPLF trade groups.

D. ARGUMENTS FOR DISCLOSURE OF LAW FIRM FINANCING

As noted above, proponents of disclosure of commercial TPLF argue that it would help enforce ethical prohibitions on fee-splitting.[53] This justification for disclosure has been challenged by some academic experts in legal ethics, who argue that it is highly unusual for the federal rules of procedure to be used to promote the enforcement of rules of professional responsibility, which are clearly the province of the states and (as in the case of so-called fee-splitting) may not mean the same thing in all states.[54]

Proponents of disclosure have additional arguments that do not depend on using federal rules of civil procedure to support or reinforce state law. They argue that in the context of mass and class federal actions, disclosure of third-party funding of law firms promotes the ends of the federal rules under which the lawyers operate.

In the context of class action, proponents of disclosure have argued that the existence of TPLF is necessary for a court to evaluate the adequacy of class counsel under FRCP 23(a)(4)'s adequacy-of-representation prerequisite.[55] The argument has found support in *Gbarabe v. Chevron Corp.*, where a lawyer seeking appointment as lead counsel was required to disclose the terms of a commercial TPLF agreement.[56] Furthermore, the same federal district court in which *Gbarabe* was decided has adopted a local rule requiring the disclosure of TPLF in cases

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[53] *See, e.g*. Chamber Letter at 13.

[54] *See* Letter to the Standing Committee, Sept. 26, 2017 from Professors W. Bradley Wendel and Anthony J. Sebok on Proposed Amendment to Rule 26. The New York City Bar Association's Working Group on Litigation Funding has issued a report which includes, among other recommendations, two competing recommendations about amendments to N.Y.R.P.C. 5.4(a) to allow law firm financing. *See Report to the President by the New York City Bar Association Working Group On Litigation Funding,* (February 28, 2020), http://documents.nycbar.org/files/Report_to_the_President_by_Litigation_Funding_Working_Group.pdf One ("Proposal A") would require the client's informed consent to the financing, and therefore disclosure. Whether lawyer-directed TPLF should be disclosed to the client, either to enable informed consent or for some other purpose, is outside the scope of this essay.

[55] *See, e.g*., Chamber Letter at 21.

[56] 2016 U.S. Dist. LEXIS 103594 (N.D. Cal. Aug. 5, 2016).

brought under FRCP Rule 23.[57] At least one other federal district court is considering a similar step.[58] The motivation behind the disclosure rule adopted by the Northern District of California is not public, and there is reason to believe that the judges who adopted the rule were motivated by concerns beyond law firm finance in class actions, or only law firm finance.[59] In 2019, a bill was introduced in the United States Senate which would amend the portion of the United States Code pertaining to class actions to require disclosure of TPLF.[60] The bill's disclosure requirements are similar to those required by the Northern District of California. In a press release, the senators sponsoring the bill said that TPLF in class actions may create a risk of "conflicts of interest" which could be addressed by disclosure.[61]

Finally, some reformers have focused on disclosure in litigation connected to multi-district litigation, or MDLs.[62] The policy concern behind disclosure in connection with MDLs is — according to its proponents — the risk that TPLF companies are financing so-called "lead generators" or "aggregators."[63] The facts behind this concern are hard to evaluate, since the practices lumped under the terms "lead generator" or "aggregator" are vague and involve activities that may

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[57] *See* Standing Order for all Judges of the Northern District of California, Contents of Joint Case Management Statement, § 19 (Jan. 2017), requiring that "in any proposed class, collective, or representative action, the required disclosure includes any person or entity that is funding the prosecution of any claim or counterclaim."

[58] *See* Ben Hancock, *Bentham Hires Yetter Coleman Partner as It Expands to Texas*, TEXAS LAWYER, Feb. 21, 2017, https://www.law.com/texaslawyer/almID/1202779591965/Bentham-Hires-Yetter-Coleman-Partner-as-It-Expands-to-Texas/ ("Ron Clark, chief judge of the Eastern District of Texas, told TEXAS LAWYER that jurists in his division may follow the Northern District of California's lead and consider similar measures.").

[59] *See* Ben Hancock*, Northern District, First in Nation, Mandates Disclosure of Third-Party Funding in Class Actions*, THE RECORDER, Jan. 23, 2018, https://www.law.com/therecorder/almID/1202777487488/Northern-District-First-in-Nation-Mandates-Disclosure-of-ThirdParty-Funding-in-Class-Actions ("The court's Civil Rules Committee, chaired by Judge Richard Seeborg, had proposed a broader rule that would have required the automatic disclosure of funding agreements in any matter before the court" but it was narrowed.).

[60] The Litigation Funding Transparency Act of 2019, section 2 (introduced by Sens. Grassley (sponsor), Cornyn, Sasse and Tillis on Feb. 13, 2019).

[61] *Grassley Leads Lawmakers in Introducing Bill to Improve Transparency of Third Party Financing in Civil Litigation*, Feb. 13, 2019, https://www.grassley.senate.gov/news/news-releases/grassley-leads-lawmakers-introducing-bill-improve-transparency-third-party

[62] *See* Rules for Rulemaking at 10 - 11.

[63] *Ibid*.

be performed by lawyers and nonlawyers.[64] In general, these third parties help lawyers seeking to participate in MDLs of other mass actions find clients.[65] Unlike class actions, which may provide for more transparency (in theory) because of the fiduciary-type power of a federal judge under FRCP 23, MDLs are relatively opaque.[66] The connection between TPLF and disclosure is that if defendants and courts in MDLs can learn about the interest third parties have in lead generation, the risk of frivolous and fraudulent claiming will be reduced.[67] For this reason, the Lawyers for Civil Justice have, in addition to supporting the amendment to FRCP 26 proposed by the Institute for Legal Reform, proposed amending Rule 26 so that "any third-party claim aggregator, lead generator, or related business or individual, who assisted in any way in identifying any potential plaintiff(s)" would be disclosed.[68] The one fact that is missing from the policy arguments for

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[64] *See* Paul M. Barrett, *Need Victims for Your Mass Lawsuit? Call Jesse Levine*, BLOOMBERG BUSINESSWEEK (Dec. 12, 2013), http://www.bloomberg.com/bw/articles/2013-12-12/mass-tort-lawsuit-lead-generator-jesse-levine-has-victims-for-sale (examining the mass tort lead generation business).

[65] *See* Jason Rathod & Sandeep Vaheesan, *The Arc and Architecture of Private Enforcement Regimes in the United States and Europe: A View Across the Atlantic*, 14 U.N.H. L. REV. 303, 360 (2016) ("[A]ttorneys litigating these cases assemble large inventories, usually with the assistance of a cottage industry of lead generation and referral firms.").

[66] *See* Elizabeth Chamblee Burch and Margaret S. Williams, *Judicial Adjuncts in Multidistrict Litigation,* Colum. L. Rev. (forthcoming 2021), University of Georgia School of Law Legal Studies Research Paper No. 2020-22, Available at SSRN: https://ssrn.com/abstract=3610197 *and* Francesca Mari, The Lawyer Whose Clients Didn't Exist, THE ATLANTIC (May 2020).

[67] *See* Rule for Rulemaking at 11–12. At least one MDL court has allowed (limited) discovery of TPLF-related materials (although not necessarily the TPLF contracts themselves). *See* In re Am. Med. Sys.*,* 2016 U.S. Dist. LEXIS 84838 (S.D. W. Va. May 31, 2016) at *15:

> [M]uch of the information sought by AMS's subpoenas is relevant . . . AMS reasonably seeks to understand the motivation behind the plaintiffs' decisions to undergo corrective surgeries and how those surgeries were funded. A rational place to start is with the beginning of the money trail — the first entity interacting with the plaintiffs before the decision to have a corrective surgery is made.

[68] *See ibid* at 12:

> In order to provide transparency to courts and parties, the Committee should amend Rule 26(a)(1)(A)(i) to include the following required disclosure:
>
>> The name and, if known, the address and telephone number of each individual likely to have discoverable information…and if relevant, a disclosure of any third-party claim aggregator, lead generator, or related business or individual, who assisted in any way in identifying any potential plaintiff(s), and if relevant, the identification of any plaintiff that was recommended, referred, or otherwise directed to plaintiff's counsel based on a recommendation,

disclosure of TPLF financing in connection with lead generation in MDLs (or any litigation, for that matter) is the degree to which commercial or consumer TPLF firms finance companies (or lawyers) that specialize in identifying plaintiffs for mass tort cases — the question of whether (and how) to respond to the recent emergence of MDLs in the mass tort space should not be conflated with the question of whether TPLF is a casue of the former.

Despite the very tenuous connection between MDL lead generation and TPLF firms, the Advisory Committee on Civil Rules chose to continue to consider amendments to FRCP 26 in the context of MDLs.[69] Rather than endorse the disclosure recommendation urged by groups like the Institute for Civil Justice, the committee asked the Subcommittee on MDLs to gather more information about TPLF.[70] It is not clear why the question of disclosure of TPLF was given to the Subcommittee on MDLs.[71] It is also not clear that the committee views itself as limited in future discussions over FRPC 26 to disclosure relating only to MDLs (or class actions).[72] The only thing that is clear is that the Subcommittee on MDLs is

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> referral, or other information gathered from such a third party claim aggregator, lead generator, or related business or individual.

[69] *See* Amanda Bronstad, *Federal Rules Advisory Panel to Eye Litigation Financing—Sort Of*, NAT'L L.J., Nov. 8, 2017, https://www.law.com/nationallawjournal/sites/nationallawjournal/2017/11/08/federal-judicial-panel-to-consider-litigation-financing-sort-of/ ("A federal judicial body plans to look into rules changes concerning disclosure of third-party financing of litigation—a move praised by the U.S. Chamber of Commerce—but the breadth of that probe could be limited.").

[70] *See* March 2018 Report of the Standing Committee to the Chief Justice:

> The advisory committee has received a suggestion to add a new Rule 26(a)(1)(A)(v) that would require automatic disclosure of 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. . . . The committee referred the issue to the MDL subcommittee, since one of the MDL proposals discussed above explicitly calls for disclosure of third party financing agreements. Additionally, such funding agreements are often used in MDL proceedings. The subcommittee will study the issue in an effort to determine whether it is something that should be pursued.

[71] At least one member of the Advisory Committee held the view that TPLF is overrepresented in MDLs. *See* Draft Minutes, Civil Rules Committee, November 7, 2017 *in* Civil Rules Advisory Committee Agenda Book (Apr. 2018) at lines 692–93 ("A judge suggested that third-party funding seems to be an issue primarily in patent litigation and in MDL proceedings.").

[72] *See* Standing Committee Report at 250 (emphasis added):

> The Committee concluded that these questions can be delegated, at least initially, to the Subcommittee appointed to develop information about the MDL proposals. One of the MDL proposals explicitly incorporates the proposal for disclosure of third-party financing agreements. There is reason to believe that MDL litigation is one of

currently the institutional focal point of any future efforts to adopt new disclosure requirements on TPLF in the federal rules.

The Litigation Funding Transparency Act of 2019, discussed above, would also require automatic disclosure of any agreement which provides for payment to a commercial third party contingent upon proceeds being generated in a case within the jurisdiction of 28 U.S. Code § 1407, the federal law governing multidistrict litigation.[73] The policy justification for extending the scope of disclosure beyond class actions to MDLs in the Act is not clearly stated by its sponsors, but supporters of the Act have suggested that TPLF in MDLs "allows hedge funds to . . . charge sky-interest rates — sometimes up to 200 percent — and leave plaintiffs [in MDLs] with settlements of just pennies on the dollar."[74] This is not an argument for disclosure in MDLs *per se,* as opposed to disclosure in any federal case (which is what the proponents of changes in Rule 26 have recommended) and it is not clear how disclosure would address the evil of high costs of litigation financing to individual plaintiffs, since a federal judge has no authority to determine compensation for individuals in an MDL, although they can monitor the allocation of common benefit fees where there is an agreement by all parties to settle while a court retains jurisdiction under 28 U.S. Code § 1407.[75]

III. COST AND BENEFITS OF DISCLOSURE

A. INTRODUCTION

Before discussing the costs and benefits of disclosure of TPLF, it must be noted that there is little empirical data upon which to base an evaluation. As mentioned above, the only law or court rules specifically intended to require disclosure of

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> the prominent occasions for third-party funding. This Subcommittee's work will prepare the way for a determination whether third-party financing disclosure should be pursued.

[73] *See* The Litigation Funding Transparency Act of 2019, section 3.

[74] *See* Lisa A. Rickard, *Who's Behind The Curtain? Congress Needs To Require Third-Party Litigation Disclosure*, DES MOINES REGISTER, June 4, 2018.

[75] *See* Morris A. Ratner, *Achieving Procedural Goals Through Indirection: The Use of Ethics Doctrine To Justify Contingency Fee Caps in MDL Aggregate Settlements,* 26 GEO. J. LEGAL ETHICS 59, 59 - 60 (2013).

TPLF to the court and an adverse party are the recently enacted Wisconsin law and the local rule adopted by the Northern District of California.

Other local rules that require the disclosure of a party interested in the outcome of litigation, such as Federal Rule of Appellate Procedure 26.1 and Federal Civil Rule 7.1, which concerns corporate disclosure statements, have always existed, but the idea that they cover TPLF is new, paralleling the recent rise of TPLF in the market. The Advisory Committee reviewed existing local rules of federal circuit and district courts and concluded that some of these courts have versions of Rules 26.1 and 7.1 which require disclosure of funding, although none of them were drafted explicitly with that purpose and it is not clear whether these rules have been interpreted until now to require disclosure of TPLF.[76] The committee concluded that six federal appellate courts had local rules that extended Rule 26.1 in some way that might require disclosure of the existence of TPLF, such as the local rule in the Eleventh Circuit, which would require disclosure of must contain a complete list of all "persons, associations of persons, firms, partnerships, or corporations that have an interest in the outcome of the particular case or appeal."[77] The same memorandum also noted that, while no other district court "has (yet) followed the Northern District of California's lead to identify expressly class action lawsuits as a civil action in which the disclosure of litigation funders is required. . . 23 other district courts require that parties identify litigation funders in any civil action under local rules related to Federal Rule of Civil Procedure 7.1."[78] These district courts, like the circuit courts, have local rules that extend Rule 7.1 and require disclosure of any person or entity (other than the parties to the case) that has a "financial interest in the outcome of the proceeding."[79] According to the memorandum, the "plain language of these local rules encompasses litigation

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[76] *See* Memorandum from Patrick A. Tighe, Rules Law Clerk: Survey of Federal and State Disclosure Rules Regarding Litigation Funding, February 7, 2018 (hereafter "Survey of Disclosure Rules"). Appellate Rule 26.1 provides that "[a]ny nongovernmental party to a proceeding in a court of appeals must file a statement that identifies any parent corporation and any publicly held corporation that owns 10% or more of its stock or states that there is no such corporation."

[77] 11th Cir. L. R. 26.1-2(a) *and see* Andrew Strickler, *3rd-Party Funders Must Be Disclosed In 6 Fed. Appeals Courts*, LAW360, Mar. 27, 2018, https://www.law360.com/legalethics/articles/1026646/3rd-party-funders-must-be-disclosed-in-6-fed-appeals-courts

[78] *See* Survey of Disclosure Rules at 4, *supra* note 76. FRCP 7.1 provides in relevant part that any "nongovernmental corporate party must file 2 copies of a disclosure statement that: (1) identifies any parent corporation and any publicly held corporation owning 10% or more of its stock; or states that there is no such corporation."

[79] Survey of Disclosure Rules at 4.

funders because a litigation funder will receive proceeds from the settlement or judgment if the contracting party prevails," but although some might require a description of the "nature of litigation funder's financial interest," none require disclosure of the litigation finance agreement itself, something the proposed amendment to Rule 26 would require.[80]

As the memorandum notes, the stated justification for the disclosure requirements in the circuit courts "is to help judges assess recusal and disqualification."[81] The disclosure requirements in the local rules in the district courts, similarly, are intended "to assist judges with assessing possible recusal or disqualification."[82] The memorandum notes that commercial TPLF companies have not, up to now, considered the disclosure rules discussed in the memorandum to require disclosure of TPLF, and the memorandum cites only one recent episode where TPLF was revealed as a result of court-ordered compliance with a version of Rule 7.1.[83] Further, although it would have been outside of the scope, the memorandum does not discuss how likely disclosure under the rules it reviewed would lead to recusal, since the memorandum does not purport to speculate about the likelihood that judges have relations with TPLF companies that would require recusal under current standards of judicial conduct.

While it is possible that the recent explosion of proposals for disclosure targeted at TPLF is intended to address a dramatic increase in the risk of conflict of interest that existing rules of court are inadequate to prevent, it is likely that the proponents of the new proposals have other ends in mind. As the next section will illustrate, the cost of complying with the proposed disclosure rules may increase, depending on their application by the courts. The possibility cannot be ignored that for many of the proponents of the new disclosure rules, uncertainty and excess costs of compliance is a feature, not a bug in the system they wish to create. That is, it may be the case that the goal is to adopt rules whose stated benefits are admittedly rarely realized, but whose real benefit is that they make every TPLF transaction more costly.

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[80] *Id.*

[81] *Id.* at 2.

[82] *Id.* at 5.

[83] *Id.* at 5–6 ("compliance with these local rules is difficult to ascertain"), *and see* Notice of Interested Parties, *Realtime Adaptive Streaming LLC v. Hulu*, LLC, No. 2:17-cv-07611-SJO-FFM, Dkt. No. 18 (C.D. Cal. Oct. 24, 2017).

B. COSTS OF DISCLOSURE

The costs of disclosure can be discussed in only the most general and speculative terms. Obviously, to the extent that some disclosure of TPLF is already required by existing law, it might be observed that the costs seem to be law and manageable, since TPLF is growing and, except for a few disputes over waiver of privilege, the costs of enforcing the current disclosure regime seem relatively low. But the relevant question is whether proposals for additional disclosure, either through the amendment of federal and state laws and local rules, will impose additional costs, and what those costs will be.

1. Direct Economic Costs

It is likely that mandatory disclosure rules will add economic costs to the parties in litigation. Parties receiving TPLF will have to take steps to comply with mandatory rules. It is possible that the direct financial costs will be low for consumer TPLF. For example, it may be that one reason consumer TPLF trade groups did not oppose the recent Wisconsin disclosure law in its final form is that they thought that it would be easy for lawyers to comply with the mandatory disclosure requirement by creating a standard document which would be triggered by a simple review of a client's file, automatically filled out by software, and filed electronically.

The direct financial costs in the context of commercial TPLF may be greater. The proposed changes to Rule 26 will create a rule which, at least initially, requires human judgment in its application. Needless to say, courts in multiple federal circuits and districts will have to interpret the rule, and that will take time to resolve contradictory judicial interpretations. There is no settled understanding of what sort of beneficial interest falls under the phrase "any person . . . [who] has a right to receive compensation contingent on, and sourced from, any proceeds of [a] civil action."[84] The divergent interpretations confronting a party is already indicated in the diversity of requirements adopted by federal district courts attempting to expand disclosure requirements under Rule 7.1.[85] Furthermore, as

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[84] This is taken from the amendment to Rule 26 proposed by the Institute for Legal Reform, *supra* note 24.

[85] [D]istrict courts vary in the type of financial interest that parties must disclose. Some require identifying any entity with "a financial interest" whereas others require disclosing only those entities with a "direct financial interest" or a "substantial financial interest.

Survey of Disclosure Rules at 6.

noted by some courts in the course of weighing relevancy, the speculative quality of defendants' rationales for discovery of documents connected with TPLF weigh *against* burdening the parties who hold the material, given FRCP Rule 26's stated concern that discovery be proportional.[86]

If the proposed disclosure rules are given their broadest possible application, then the financial consequences of reporting may be borne by parties who are not TPLF firms, and are far outside the scope of the policy concerns reviewed above that have motivated the proposed changes. To take a very real example, the recently adopted Wisconsin legislation, on its face, would require a plaintiff to disclose the identity and interest of any person with a contingent right to proceeds, including an insurance subrogree, or a claimant who took a bank loan with the litigation claim as security, or a personal loan among family members, or even a deferred healthcare fee to be paid with the proceeds of a personal injury lawsuit. While the direct cost of disclosure will be borne by the plaintiff (or, more likely, their attorney), collateral costs related to the exchange of information and the monitoring of the disclosure will be borne by the third parties.

2. Indirect Economic Costs

The indirect of economic costs of adding new disclosure requirements are very hard to measure. Any added cost to litigation reduces access to justice; this is a well-understood principle that motivates advocates and opponents of so-called tort reform, which is designed, in part, to make it more expensive for parties and their lawyers to bring lawsuits.[87] The direct costs of disclosure were canvassed in the previous section. The indirect costs include (a) increases in the cost of capital, for both parties and plaintiff's attorneys (if they have to substitute TPLF with advances) and (b) additional litigation expenses generated by pre-trial motion practice — specifically additional discovery requests — prompted by disclosure.[88]

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[86] *See, e.g.,* In re Valsartan N-Nitrosodimethylamine (NDMA) Contamination Prods. Liab. Litig, 2019 U.S. Dist. LEXIS 160051, at *32 ("Even if plaintiffs' litigation funding is marginally relevant, which is not the case, defendants' requested discovery would be denied because it is not 'proportional to the needs of the case.'") (*citing* Space Data Corp. v. Google LLC, 2018 U.S. Dist. LEXIS 228050 (N.D. Cal. June 11, 2018) at *1).

[87] *See, e.g.,* STEPHEN DANIELS & JOANNE MARTIN, TORT REFORM, PLAINTIFFS' LAWYERS, AND ACCESS TO JUSTICE (2015).

[88] Additional discovery costs are one reason that commercial TPLF firms opposed the Wisconsin disclosure legislation. *See* Ben Hancock, *Litigation Funding Deals Must Be Disclosed Under Groundbreaking Wisconsin Law*, NAT'L L.J., Apr. 04, 2018, https://www.law.com/2018/04/04/wisconsin-

As Professor Maria Glover has put it, "disclosure of the fact of funding, or anything relating to funding in relation to the court, is a bit of a tax on a funded party, and not something that we would require were there not funding available."[89]

Finally, it is possible that the true motivation behind many disclosure proposals is not only to increase direct and indirect costs of litigation, but to affect public opinion about the value and desirability of TPLF. One consequence of disclosure is the possibility of public access to the details of TPLF agreements. There may be a hope that, although most TPLF agreements might be of no interest to the press or the public at large, some agreements might contain terms or reflect motivations that might cast the whole TPLF sector in a bad light.[90]

3. Comparison With Other Disclosure Rules

It is very difficult to draw any conclusions about the direct economic costs of expanding disclosure of TPLF by comparing it to other disclosure laws and rules unconnected to TPLF. As mentioned above, the disclosure regime imposed by Federal Rule of Appellate Procedure 26.1 and Federal Civil Rule 7.1, which have, until now, been intended to help courts avoid conflicts of interest with the parties before them, seems to offer little useful guidance. The only other disclosure rule that might have relevance concerns the mandatory initial disclosure of liability insurance coverage under Rule 26(a)(1)(A)(iv). In 1970, the Committee amended Rule 26(b)(2) to require disclosure of a defendant's insurance coverage because it felt that "[d]isclosure of insurance coverage will enable counsel for both sides to make the same realistic appraisal of the case, so that settlement and litigation strategy are based on knowledge and not speculation."[91] Amendments to Rule 26 were adopted in order to help parties to make choices about conducting litigation

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litigation-funding ("'This provision in the amended statute will, in all likelihood, increase the number of discovery disputes and thus the cost of litigation for both plaintiffs and defendants,' Allison Chock, the chief investment officer for Bentham IMF, said in an email.").

[89] See *Panel 4: Litigation Funding and the Federal Rules of Civil Procedure*, 12 N.Y.U. J.L. & BUS. 603, 630 (2016).

[90] While TPLF may be legal, it may also offend public opinion when used for certain ends. This may explain why, for example, Peter Thiel took every effort to conceal his TPLF arrangement in the litigation against Gawker by "Hulk" Hogan. *See* Ryan Mac, *Behind Peter Thiel's Plan To Destroy Gawker*, FORBES, June 7, 2016, https://www.forbes.com/sites/ryanmac/2016/06/07/behind-peter-thiel-plan-to-destroy-gawker/#5876242f30f4

[91] Fed. R. Civ. P. 26(b)(2) advisory committee's note to 1970 amendment.

and to allow both sides to have (as much as possible) the same information about resources available for settlement.[92]

Leaving aside whether the same policy goals would be served by changing Rule 26 to require disclosure of TPLF as are served by requiring disclosure of liability insurance, a separate question can be asked about the burden imposed by the two disclosure regimes. The mandatory disclosure requirement of liability insurance in Rule 26 is much narrower in scope than the proposal to require mandatory disclosure of TPLF under discussion. As the Advisory Committee on Civil Rules noted:

> [D]isclosure is carefully limited to an agreement with "an insurance business." Other forms of indemnification agreements are not covered. Nor is discovery generally allowed into a defendant's financial position, even though both indemnification agreements and overall resources may have impacts similar to, or even exceeding, the impact of liability insurance.[93]

The proposed amendment to Rule 26 would extend to "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," and thus would extend to a far larger universe of materials.[94]

The significance of the more limited obligation in Rule 26's liability insurance disclosure requirement can be seen in the court's rejection of efforts by parties to go beyond the strict disclosure requirements of the rule to obtain documents related to the amount of a party's right to coverage. Courts have refused plaintiffs access under Rule 26 to an insurer's reservation of rights letter connected to a liability policy or an accounting of how much of the policy limits in a policy had been used for legal fees before an insured had assumed the cost of its own

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[92] Standing Committee Report at 248.

[93] *Id.*

[94] This is true about the Wisconsin law as well.

representation and secured new counsel.[95]The plain meaning of the Chamber's proposal — to require mandatory disclosure of "any agreement" involving litigation finance— would allow a defendant to obtain information about a plaintiff's litigation posture that courts prohibit plaintiffs from securing under the insurance disclosure requirements supporters of expanded disclosure for TPLF. Regardless of whether the additional burden is worth it, it must be admitted that the scope of the obligation will be greater for plaintiffs than defendants.

4. Costs to Lawyers

In addition to the direct and indirect costs of compliance detailed above, which assume that legal resources will have to be dedicated toward complying with, and interpreting, the obligations that TPLF disclosure rules would impose, there is an additional cost that is borne only by lawyers. Compliance assumes competent legal advice, which, of course, is the basic obligation of all lawyers.[96] Unless a lawyer chooses to limit her scope of representation and explicitly refuse to advise a client on compliance with new TPLF disclosure requirements, she will have to advise a client on compliance, and probably assist the client as well, by gathering materials and filing the relevant forms. None of this represents unusual legal work (as is evidenced by the fact that certain statements relating to liability insurance coverage is presumably compiled by lawyers under FRCP Rule 26(a)(1)(A)(iv) for defendants), but it represents an expansion of a lawyer's exposure to both discipline and malpractice liability. Failure by a lawyer to reasonably advise a client on new mandatory disclosure requirements may result in injury to the client, and therefore civil liability.[97] Failure by a lawyer to disclose any documents within the scope of a mandatory TPLF disclosure rule (or to amend after the fact a failure of a client to disclose) would open the lawyer up to discipline under Rule 3.3(a)(1).[98] Lawyers have already been sued (albeit unsuccessfully) by clients who

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[95] *See, e.g.,* Native American Arts, Inc. v. Bundy-Howard, Inc., No. 01 C 1618, 2003 WL 1524649 (N.D. Ill. Mar. 20, 2003) *and* Excelsior College v. Frye, 233 F.R.D. 583 (S.D. Cal. 2006).

[96] *See* Model Rules of Professional Conduct ("MRPC"), Rule 1.1 (Competence).

[97] Since no current proposal for expanded TPLF disclosure includes any preservation of privilege, it must be presumed that parties are waiving privilege with regard to the documents disclosed. By definition, then, a lawyer will have to provide adequate counsel to secure from her client informed consent for disclosure if it would lead to the waiver of evidentiary privileges or the release of confidential information protected under MRPC 1.6.

[98] MRPC Rule 3.3: Candor Toward The Tribunal

> (a) A lawyer shall not knowingly:

have been unhappy with their advice with regard to a TPLF contract.[99] Clearly, by expanding the exposure of lawyers to liability and discipline, additional costs (of care, self-insurance, and malpractice insurance) will be imposed on lawyers who have clients who seek TPLF.

B. BENEFITS OF DISCLOSURE

Like the costs of disclosure, the benefits are also speculative and hard to predict (or measure). The most commonly cited benefit is that by requiring TPLF to be disclosed at an early stage in litigation, judges will be able to recognize conflicts and recuse themselves.[100] This argument has found some traction in parallel debates that have occurred in international arbitration.[101] The parallel with international arbitration is not very useful, however, since international arbitration employs neutral decision-makers who are often drawn from practice, and who may have direct professional relations with TPLF firms. Judges in the United States, on the other hand, while sometimes connected to practice through previous employment, more often face recusal based on financial interests such as ownership of shares in a corporation whose interests will be affected by the outcome of a case before the judge.[102] Given the very small size of the TPLF market, and the even smaller number of publicly traded TPLF firms, the risk of financial interest through shareholding or other forms of investment among judges seems extremely low, and as yet, no one has produced any data to suggest that it is a problem of such scale that special amendments to existing law are required to address it.

A second benefit that has been cited is the specific role that disclosure of TPLF may play in insuring that a court may evaluate a lead counsel with complete information about its financial resources. This argument was the reason that the

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> (1) make a false statement of fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer.

[99] *See, e.g.,* Francis v. Mirman, Markovits & Landau PC, N.Y. Sup. Ct. Kings Cty., No. 29993/10 (Jan. 3, 2013).

[100] *See* Standing Committee Report at 249.

[101] *See* Maria Choi, *Third-Party Funders in International Arbitration: A Case for Protecting Communication Made in Order to Finance Arbitration*, 29 GEO. J. LEGAL ETHICS 883, 889 (2016) ("In response to the rising concerns about conflicts of interest, the IBA Guidelines on Conflicts of Interest were revised in October 2014 to include reference to third-party funders.").

[102] *See* Ziona Hochbaum, *Note, Taking Stock: The Need to Amend 28 U.S.C. § 455 to Achieve Clarity and Sensibility in Disqualification Rules for Judges' Financial Holdings*, 71 FORDHAM L. REV. 1669 (2003).

Northern District of California changed its local rules in connection with class action. It is hard to know whether class members will truly benefit from the new rule. Obviously, it is in no one's interest for a class to have inadequately capitalized counsel appointed, and to the extent that the rule causes a court to appoint a different lead counsel who would secure a better result for the class, the benefit, even if marginal, may exist. To the extent that the rule is used tactically by defendants to defeat the appointment of class counsel where none takes its place, it is not clear that the rule does work to the advantage of potential class members.

The remaining benefits seem to be directed toward using disclosure as a vehicle for the deterrence of conduct which is prohibited already under existing law. The argument that TPLF disclosure will expose violations of the prohibition of champerty in those states in which it is prohibited does not rely on the claim that disclosure will help improve the integrity of proceeding in which the disclosure occurs, but that it will help prevent wrongdoing that should never have been connected with the proceeding anyway. The same point can be made about the putative benefit of disclosure with regard to violations of the rules of professional responsibility by lawyers who allow third parties to interfere with their independent professional judgment in violation of MRPC 5.4(c).[103] TPLF can be provided without a lawyer violating her obligation of independent professional judgment to her client, and it is not clear why the exiting law — including the existing mechanisms for the discipline of lawyers who violate their obligations to the bar — are not sufficient to address violations of Rule 5.4(c), to the extent that they arise in the context of TPLF.[104]

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[103] MRCP Rule 5.4: Professional Independence Of A Lawyer

> (c) A lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services.

[104] It should be observed that violations of Rule 5.4(c) have been documented in the context of liability insurance contracts. *See* Douglas R. Richmond, *Walking a Tightrope: The Tripartite Relationship Between Insurer, Insured, and Insurance Defense Counsel*, 73 NEB. L. REV. 265, 283 (1994). Despite the well-documented risk of a lawyer violating her obligation to provide the client with independent professional judgment, Rule 26 was not amended to deal with that issue — just the issue of conflicts of interest and recusal.

IV. CONCLUSION AND RECOMMENDATIONS

Argument for most disclosure rules in TPLF faces two challenges. First, the problems the proposed rules aim to solve are not ones that seem important or pressing. For example, the risk that judicial conflict of interest due to stock ownership by judges in TPLF companies seems, at this point, mostly in the imagination of the proponents of the disclosure rules. Second, the costs of compliance with the disclosure rules may be large, depending on how the rules are framed and interpreted. As a result, the best course of action is caution, both in supporting disclosure and in designing disclosure rules. This paper will conclude by making two recommendations.

1. MAKE DISCLOSURE WORK FOR CONSUMERS

The most serious criticism of consumer TPLF is that consumers are not getting as much from their transactions with TPLF firms as they could. Proposals to set a price for how much a consumer TPLF firm must pay for a contingent portion of a consumer's litigation outcome are a form of price control, and price controls are often the last resort for those seeking to protect consumers. (Usury law is a form of price control.) There is no reason to believe — at this point — that markets cannot operate to set prices in this part of consumers' lives as they do in other parts of their lives. However, for markets to work, there must be transparency and information, and the current consumer TPLF sector lacks both.

Most consumer TPLF contracts are not transparent, since they include many contract terms that are difficult for consumers to understand and compare in order to shop around for the best deal for their lawsuit.[105] Simple pricing — without additional terms such as application fees which are paid only if the consumer's application is accepted by the funder and the lawsuit is eventually successful — would help consumers know how much the transaction will earn them, so that they can, if they wish, comparison shop. While some disclosure reforms supported by the TPLF industry call for disclosure, disclosure rules could go further by

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[105] *See* Avraham & Sebok, *An Empirical Investigation of Third Party Consumer Litigation Funding*, *supra* note 51. For a very preliminary exploration of the role of consumer protection in consumer legal finance from one of the authors, see Ronen Avraham, Lynn A. Baker, and Anthony J. Sebok, *The Anatomy of Consumer Legal Funding* (August 10, 2020). Cardozo Legal Studies Research Paper No. 618, U of Texas Law, Public Law Research Paper Forthcoming, U of Texas Law, Law and Econ Research Paper Forthcoming, Available at SSRN: https://ssrn.com/abstract=3670825

prohibiting certain pricing devices that could be replaced by simpler pricing mechanisms.

2. DISCLOSURE TO THE COURT SHOULD BE LIMITED AND IN CAMERA

To the extent that disclosure in commercial TPLF and TPLF in class actions and MDLs is valuable, it should be limited to the audience who needs to be informed: the court. None of the arguments presented by advocates for broad disclosure justify disclosure of funding documents to adverse parties. The cost of such disclosure has been reviewed above, and, while that cost can be contained, there seems to be no reason for the typical plaintiff to bear that cost at all. A simpler solution is to allow the court — and only the court — to examine the facts of the funding relevant to the court's needs and to determine, based on that preliminary inquiry, whether broader disclosure is warranted.

A good example of targeted disclosure is the order issued on May 7, 2018, in *In Re: National Prescription Opiate Litigation*.[106] Judge Dan Aaron Polster ordered any attorney who has obtained litigation financing to submit, ex parte and in camera, the identity of the financer and to affirm that the financing does not create any conflict of interests, undermine counsel's obligation of vigorous advocacy, affect counsel's independent judgment, give the lender any control over litigation strategy or settlement decisions, and affect party control of any settlement.[107] The order left open the possibility that discovery by adverse parties into TPLF agreements could occur under "extraordinary circumstances".[108]

Judge Polster's order is a good model for future legislation, but it also lays bare the weakness of the argument for law reform addressing disclosure of TPLF. At the most, legislation implementing Judge Polster's order would provide judges with another tool to monitor conflicts of interest. The meaning of "extraordinary circumstances" in Judge Polster's order is not clear, and although future opinions may illuminate it, it is unlikely that the judge intended this caveat to take up much

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[106] MDL Docket No. 2804, No. 17-md-2804 (N.D. Ohio, Eastern Div.).

[107] *Ibid.* The order also held that the work product doctrine could preserve privilege over certain communications between the plaintiffs and third-party funders. *Ibid* at 2, *citing* Lambeth Magnetic Structures, LLC v. Seagate Tech. (US) Holdings, Inc. Judge Polster's approach was adopted in *In re Valsartan N-Nitrosodimethylamine (NDMA) Contamination Prods. Liab. Litig*, 2019 U.S. Dist. LEXIS 160051 at *40.

[108] *Id.*

of the court's time or produce significant benefits for the parties. In other words, Judge Polster's additional disclosure requirements are modest in both ambition and significance. They deserve support, but they are not intended to achieve more than a marginal increase in protection for the integrity of the judicial process. This is not a criticism of Judge Polster's order, but a recognition that an objective study of the issues raised by TPLF in MDLs entails the conclusion that there is little need for more than minor reform with regard to disclosure of TPLF.

Follow the Money? A Proposed Approach for Disclosure of Litigation Finance Agreements

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Originally published in *UC Davis Law Review,* Volume 53, Issue 2

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Litigation finance is the new and fast-growing practice by which a nonparty funds a plaintiff's litigation either for profit or for some other motivation. Some estimates placed the size of the litigation finance market at $50-$100 billion. Both proponents and opponents of this newly emergent phenomenon agree that it is the most important civil justice development of this era. Litigation finance is already transforming civil litigation at the level of the single case as well as, incrementally, at the level of the civil justice system as a whole. It is also beginning to transform the way law firms are doing business and it will increasingly shape the careers of civil litigators at firms small and large. Consequently, Congress, state legislatures, state and federal courts, bar associations, international arbitration institutions, foreign legislatures, and foreign courts are concurrently grappling with how to regulate litigation finance and what, if any, disclosure requirements to impose on such financing.

This Essay aims to turn the debate inside out by proposing to abandon the quest for a bright line rule and to instead adopt a flexible, discretionary standard: a balancing test. The Essay culminates in a specific proposal for the contours — the interests and factors — which judges and arbitrators should be empowered and required to weigh when deciding whether and what form of disclosure to require. More specifically, the Essay details and rationalizes the specific public and private interests and factors to consider, including the profile of the plaintiffs and their motive for seeking funding, the funder's profile and motivation, the case type and the forum, the subject matter of the litigation, the potential effect on the development of the law, the structure of the financing, the purpose of the contemplated disclosure, and the procedural posture of the case.

INTRODUCTION

Both critics and proponents of the newly emergent phenomenon of litigation finance agree that the practice is likely the most important development in civil justice of our time.[109] Litigation finance is transforming civil litigation at the case level as well as, incrementally, at the level of the civil justice system as a whole. It is beginning to transform the way law firms are doing business and will increasingly shape the careers of civil litigators at firms small and large. It is unsurprising, therefore, that litigation finance is of interest to legislatures and the courts. At the state and federal level, in the judiciary, the legislatures, and at bar associations, the question of the day is whether and how to regulate litigation finance. That debate, and this Essay, focuses, specifically, on regulation through disclosure of the financing.

In summary, litigation finance is the practice by which a nonparty funds a plaintiff's litigation either for profit or for some other motivation.[110] Last year, some estimates placed the size of the litigation finance market at $50-$100 billion.[111] This market in legal claims has attracted specialist firms, private equity, hedge funds, wealthy individuals, the public (through crowdfunding platforms), and sovereign wealth funds, among others, who are looking for high-risk high-reward investments or for a *cause célèbre*. The high-profile funding of Hulk Hogan's lawsuit against Gawker has created a firestorm of public and regulatory interest. The funding of the concussion litigation, #MeToo cases, and Stormy Daniels' lawsuit—to name but a few recent examples—have dominated headlines and conferences.

This Essay argues that the quest for a bright line rule by which to regulate disclosure of litigation funding is fundamentally misguided because it fails to account for the near-infinite variability of funding scenarios, which implicate widely different interests, pose different risks, and affect different constituencies in varying degrees. In other words, rules are a legal technology that simply cannot capture nor address the nuance, variability, and context-specificity that litigation

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[109] *See infra* Part II.

[110] For a fuller explanation of the myriad forms litigation finance takes, see *infra* Part III.

[111] *See* Brian Baker, *In Low-Yield Environment, Litigation Finance Booms*, MARKETWATCH (Aug. 21, 2018, 10:59 AM), https://www.marketwatch.com/story/in-low-yield-environment-litigation-finance-booms-2018-08-17 [https://perma.cc/FL5P-4HMD].

finance implicates. Instead of a bright line rule, this Essay proposes that legislatures and courts shift to a standard-based approach and adopt, specifically, a balancing test. A specific balancing test, including factors and interests to be weighed by courts on an *ad hoc* basis, is then offered.

The Essay progresses as follows. Part I contains a description of pending and recent legislation and regulations.[112] Part II explains what's at stake as litigation finance expands and is poised to reshape civil litigation, civil justice, and the legal profession.[113] Part III explains the reasons why finding a uniform approach to whether or not to mandate disclosure of litigation finance and if so in what form has proved so controversial and elusive.[114] In a nutshell, the problem is the high variability of funding scenarios. The variables are described and unpacked. Part IV explains the invisible common thread in the otherwise-divergent current regulatory and scholarly approaches: when not punting, they assume a rules-based approach.[115] It then suggests moving away from a search for a rule to the embrace of a standard.[116] Part V then suggests such a standard or, more specifically, a balancing test, spelling out interests and factors to weigh.[117]

I. THE FLURRY OF LEGISLATIVE AND REGULATORY ACTIVITY AIMED AT A DISCLOSURE REGIME

Overlapping, but incohesive and under-theorized, discourses on whether and in what way to require disclosure of litigation finance are taking place at the federal, state and international levels. This Part describes these processes, and the proposals on the table, in that order.

A. At the Federal Level

At the federal level, two battlegrounds over regulation of litigation funding are currently waged and they revolve around legislation that would target complex (class and mass) litigation, at one level, and a possible change to the Federal Rules

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[112] *See infra* Part I.

[113] *See infra* Part II.

[114] *See infra* Part III.

[115] *See infra* Part IV.

[116] *See infra* Part IV.

[117] *See infra* Part V.

of Civil Procedure ("FRCP"), on the other. With respect to the former, in May 2018, Senator Chuck Grassley, Chairman of the Senate Judiciary Committee, introduced the Litigation Funding Transparency Act of 2018 ("LFTA"), which aims "to increase transparency and oversight of third-party litigation funding in certain actions, and for other purposes."[118] The bill, reintroduced on February 13, 2019,[119] is a narrow, disclosure-only scheme that follows an earlier attempt to include litigation funding disclosure requirements as part of a broader push to restrict class actions—the unsuccessful Fairness in Class Action Litigation Act of 2017 ("FCALA").[120]

If adopted, LFTA would require disclosure of litigation funding arrangements in class actions and multidistrict litigation in federal courts to the court and to all parties.[121] LFTA's stated goal is to improve transparency and oversight of the litigation finance industry, so that the court and other parties are able to identify conflicts of interest and "know whether there are undue pressures and secret agreements at play that could unnecessarily drag out litigation or harm the interest of the claimants themselves."[122]

Critics of the bill, often large litigation funders, argue that the proposed legislation unjustifiably "mandat[es] broad disclosure to the defendant."[123] Instead, they suggest that disclosure should be limited to the court, to avoid "handing defendants an unfair advantage by getting a free look at plaintiffs' financial affairs."[124] Critics also argue that the bill would impose even greater difficulties to plaintiffs of limited economic means "by imposing more barriers to

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[118] S. 2815, 115th Cong. (2018).

[119] *See* Ross Todd, *Republican Senators Reintroduce Bill Pushing for Disclosure of Litigation Funding*, NAT'L L.J. (Feb. 13, 2019, 6:40 PM), https://www.law.com/nationallawjournal/2019/02/13/republican-senators-reintroduce-bill-pushing-for-disclosure-of-litigation-funding.

[120] *See* H.R. 985, 115th Cong. (2017).

[121] *See* S. 2815 §§ 2-3.

[122] *See* Press Release, Comm. on the Judiciary, Grassley, Tillis, Cornyn Introduce Bill to Shine Light on Third Party Litigation Financing Agreements (May 10, 2018), https://www.judiciary.senate.gov/press/rep/releases/grassley-tillis-cornyn-introduce-bill-to-shine-light-on-third-party-litigation-financing-agreements.

[123] *Burford Capital Comments on The Litigation Funding Transparency Act of 2018*, BURFORD CAPITAL: BLOG (May 10, 2018), http://www.burfordcapital.com/blog/litigation-funding-transparency-act-2018 [https://perma.cc/63XX-VMXT].

[124] *See id.*

entry for claimants trying to bring meritorious lawsuits against massive corporations."[125]

With respect to amendments to the FRCP, as of this writing, the Advisory Committee on Civil Rules ("Advisory Committee") finds itself amidst dueling lobbying efforts by proponents and opponents of litigation finance, with the latter lobbying for a revision of the Federal Rules of Civil Procedure mandating disclosure while the former endorsing retention of the *status quo*.[126] The U.S. Chamber of Commerce, the nation's leading business lobby, which has for years led the battle to eliminate or at least restrict litigation funding,[127] recently renewed for the third time its call that federal courts require parties to disclose all litigation funding agreements—including the identity of the funder and the terms of the funding—at the outset of any case in federal court. It proposed a broad amendment to FRCP Rule 26 that would require disclosure of "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."[128]

Scholars have also trained their sights on the question of disclosure in litigation finance. For example, one scholar proposes that procedural rules be revised or reinterpreted to require any party supported by a third-party funder to disclose the identity of the funder to the judge *in camera* so the judge may determine if there is a financial conflict of interest.[129] Another suggestion is that a class relying

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[125] *See* Matthew Harrison, *The Litigation Funding Transparency Act of 2018*, BENTHAM IMF: BLOG (May 14, 2018), https://www.benthamimf.com/blog/blog-full-post/bentham-imf-blog/2018/05/14/the-litigation-funding-transparency-act-of-2018.

[126] *See* ADVISORY COMM. ON CIVIL RULES, AGENDA BOOK 345-460 (Nov. 2017), http://www.uscourts.gov/sites/default/files/2017-11-CivilRulesAgendaBook_0.pdf [hereinafter AGENDA NOVEMBER 2017].

[127] *See, e.g.*, JOHN H. BEISNER & GARY A. RUBIN, U.S. CHAMBER INST. FOR LEGAL REFORM, STOPPING THE SALE ON LAWSUITS: A PROPOSAL TO REGULATE THIRD-PARTY INVESTMENTS IN LITIGATION 2, 10, 14 (2012), https://www.instituteforlegalreform.com/uploads/sites/1/TPLF_Solutions.pdf; Harold Kim, *The Time for Litigation Funding Transparency Is Now*, U.S. CHAMBER INST. FOR LEGAL REFORM (Nov. 7, 2017), https://www.instituteforlegalreform.com/resource/the-time-for-litigation-funding-transparency-is-now [https://perma.cc/D3VT-KTHA].

[128] ADVISORY COMM. ON CIVIL RULES, AGENDA NOVEMBER 2017, *supra* note 126, at 345.

[129] *See* Victoria Shannon Sahani, *Judging Third-Party Funding*, 63 UCLA L. REV. 388, 424-27 (2016). Sahani also argues that the current disclosure rules can be interpreted as

on third-party funding should be required to disclose the arrangement to the court for *in camera* review, and the decision-maker be provided at least the name of the funder.[130]

The Advisory Committee declined to take up a similar suggestion in 2014, but it left the door open for future regulation, with members noting that "[w]e do not yet know enough about the many kinds of financing arrangements to be able to make rules"[131] and that "third-party financing practices are in a formative stage. They are being examined by others. They have ethical overtones. We should not act now."[132] But more recently, in response to the latest advocacy for rule change, the Advisory Committee created a subcommittee tasked with considering the possibility of initial disclosure of third-party funders in multidistrict litigation.[133] The subcommittee recently reported that it "continues to gather information and has not yet attempted to develop recommendations about whether to consider possible rule amendments, or what amendments, if any, should be given serious study."[134]

Finally, federal courts, in typical common law fashion, have been weighing in on disclosure in litigation finance as various fact patterns increasingly come before them.[135] And while Congress is taking its time, district and appellate courts

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relating to third party funding specifically, that the term "resources" in FRCP 26(b)(2)(C)(iii) should be construed to include third-party funding and that language referencing third-party funding should be added to the lists under Rule 16(b)(3)(B) and Rule 16(c)(2) such that information about funding be disclosed as part of the rules-mandated pretrial conferences. Additionally, she suggests adding a new Rule 7.2. In the context of disclosure of third-party funding agreements for a claim for attorney's fees, she suggests enforcing disclosure under Rule 54(d)(2)(B)(iv) or revising it to include third-party funding. *See id.* at 416-34.

[130] *See* Aaseesh P. Polavarapu, *Discovering Third-Party Funding in Class Actions: A Proposal for In Camera Review*, 165 U. PA. L. REV. ONLINE 215, 233-34 (2017) (suggesting an affirmative duty on parties to disclose third-party funding agreements for *in camera* review); *see also* Sahani, *supra* note 129, at 424.

[131] ADVISORY COMM. ON CIVIL RULES, MEETING MINUTES 13 (2014), http://www.uscourts.gov/sites/default/files/fr_import/CV10-2014-min.pdf.

[132] *Id.* at 14.

[133] *See* ADVISORY COMM. ON CIVIL RULES, AGENDA BOOK 139 (Nov. 2018), https://www.uscourts.gov/sites/default/files/2018-11_civil_rules_agenda_book_0.pdf.

[134] *Id.* at 140.

[135] *See, e.g.*, Lambeth Magnetic Structures, LLC v. Seagate Tech. (US) Holdings, Inc., Nos. 16-538, 16-541, 2018 WL 466045, at *6 (W.D. Pa. Jan. 18, 2018); United States *ex rel.* Fisher v. Ocwen Loan Servicing, LLC, No. 4:12-CV-543, 2016 WL 1031157, at *6-7 (E.D. Tex. Mar. 15, 2016).

are enacting rules to deal with disclosure. As of this writing, twenty-four out of ninety-four district courts require some sort of disclosure of the identity of litigation funders in a civil case. Some of the district courts require a party to disclose the nature of a litigation funder's interest in the case. District courts impose these enhanced disclosure requirements in a number of ways, with fourteen promulgating local rules mandating broader disclosure than what is required under FRCP Rule 7.1,[136] two using standing orders, and ten using local forms which require disclosure of litigation financiers.[137] In the case of appellate courts, six U.S. circuit courts of appeal have local rules requiring expanded disclosure of litigation funders beyond the requirements of Federal Rule of Appellate Procedure 26.1.[138] These circuit courts generally require a party to disclose any person or organization with a financial interest in the litigation. Beyond this, though, the rules of circuit courts vary in details, with different circuits having different rules regarding whether amici curiae must disclose litigation financing, whether disclosures are limited to certain types of appeals, and other such issues.[139] The stated purpose of these regulations is to assist judges with evaluating possible issues of recusal and disqualification and none require automatic disclosure in every civil case.[140]

B. At the State Level

State legislatures and courts have also, increasingly, taken up the issue of litigation finance regulation in recent years. Unlike federal regulation, which tends to come up in the context of commercial litigation funding or focus on class and mass

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[136] The rule requires that "[a] nongovernmental corporate party must file two copies of a disclosure statement that: (1) identifies any parent corporation and any publicly held corporation owning 10% or more of its stock; or (2) states that there is no such corporation." FED. R. CIV. P. 7.1(a).

[137] *See* ADVISORY COMM. ON CIVIL RULES, AGENDA BOOK 210-11 (Apr. 2018), https://www.uscourts.gov/sites/default/files/2018-04-civil-rules-agenda-book.pdf [hereinafter AGENDA APRIL 2018].

[138] The rule requires that "[a]ny nongovernmental corporate party to a proceeding in a court of appeals must file a statement that identifies any parent corporation and any publicly held corporation that owns 10% or more of its stock or states that there is no such corporation." FED. R. APP. P. 26.1(a).

[139] *See* ADVISORY COMM. ON CIVIL RULES, AGENDA APRIL 2018, *supra* note 137, at 209-10.

[140] *See id.* at 210.

litigation, the focus at the state level is on consumer litigation funding.[141] Therefore, these regulatory efforts often focus on ensuring that agreements are in writing and contain terms with "common, everyday meanings to enable the average consumer who makes a reasonable effort under ordinary circumstances to read and understand the terms of the contract without having to obtain the assistance of a professional."[142]

Because the regulation of consumer funding is concerned with avoiding predatory lending-like practices, most of the state regulation is less germane to the current discussion, other than to demonstrate the prominence of the regulatory flurry around a phenomenon that is already altering the quantity, nature, and outcome of civil litigation and is poised to further do so in coming years. But some state-level developments are nonetheless worth noting in the current context. Specifically, in April 2018, Wisconsin enacted "a first-of-its-kind state law requiring litigants to disclose their outside legal funding arrangements."[143] The rule requires a party, "without awaiting a discovery request, [to] 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

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[141] *See* Maya Steinitz, *The Litigation Finance Contract*, 54 WM. & MARY L. REV. 455, 460-61 (2012) [hereinafter *The Litigation Finance Contract*] (explaining the common distinction between consumer litigation funding, which focuses on the funding of small personal claims for individual clients, and commercial litigation funding, which focuses on the funding of larger, higher value claims brought by more sophisticated parties, these parties often being business entities); *see also* Nora Freeman Engstrom, *Lawyer Lending: Costs and Consequences*, 63 DEPAUL L. REV. 377, 382-83 (2014) (noting three main types of litigation financing: consumer litigation financing, commercial litigation financing, and lawyer lending); Anthony J. Sebok, *Litigation Investment and Legal Ethics: What Are the Real Issues?,* 55 CANADIAN BUS. L.J. 111, 114-15 (2014) [hereinafter *Litigation Investment and Legal Ethics*] (describing the differences between consumer and commercial litigation investment); Victoria A. Shannon, *Harmonizing Third-Party Litigation Funding Regulation*, 36 CARDOZO L. REV. 861, 864-65 (2015) (noting the different regulatory regimes imposed on commercial and consumer litigation financing).

[142] VT. STAT. ANN. tit. 8, § 2253(a) (2015); *see, e.g.*, ARK. CODE ANN. § 4-57-109 (2015); ME. REV. STAT. ANN. tit. 9-A, § 12-104 (2008); NEB. REV. STAT. ANN. § 25-3303 (2010); OHIO REV. CODE ANN. § 1349.55 (2008); OKLA. STAT. ANN. tit. 14A, § 3-805 (2013); TENN. CODE ANN. § 47-16-104 (2014); *see also* ADVISORY COMM. ON CIVIL RULES, AGENDA APRIL 2018, *supra* note 137, at 216-17 (discussing state legislation and regulations for regulating litigation funding through registration models and caps on rates and fees).

[143] Andrew Strickler, *Wis. Gov. Signs Legal Funder Transparency Rule*, LAW360 (Apr. 3, 2018, 9:26 PM), https://www.law360.com/legalethics/articles/1029480/wis-gov-signs-legal-funder-transparency-rule.

action, by settlement, judgment, or otherwise."[144] This is the first state regulation which imposes a broad mandatory disclosure requirement for litigants funded by third parties.[145]

Finally, like their federal counterparts, state courts have also been called upon to decide whether and how litigation funding should be disclosed.[146]

C. International and Foreign Regulatory Developments

The development of litigation finance in the United States represents an expansion of an industry that first took hold in domestic litigation in Australia and the United Kingdom, and then expanded in international arbitration.[147] In the realm of international arbitration, the most important development is the creation of "soft law" in the form of a Report by the International Council for Commercial Arbitration ("ICCA")-Queen Mary Task Force on Third-Party Funding in International Arbitration, which was finalized, after a very long and public deliberative process, in April 2018. It restates the general norm emerging in international arbitration of requiring disclosure of the existence and identity of funders for the purpose of arbitrators' conflicts check and confirms the emergent

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[144] WIS. STAT. ANN. § 804.01 (2019).

[145] *See* Strickler, *supra* note 143.

[146] *See, e.g.*, Carlyle Inv. Mgmt. v. Moonmouth Co., C.A. No. 7841-VCP, 2015 WL 778846, at *8-9 (Del. Ch. Feb. 24, 2015) (litigation funding documents serve a dual litigation and business purpose, but should still be subject to work product confidentiality protections); Charge Injection Techs., Inc. v. E.I. DuPont De Nemours & Co., No. 07C-12-134-JRJ, 2015 WL 1540520, at *4 (Del. Super. Ct. Mar. 31, 2015) (since the payment terms in a litigation finance agreement were prepared in anticipation of litigation, and involved attorney mental impressions and litigation strategies, these terms should be subject to work product protection); Conlon v. Rosa, Nos. 295907, 295932, 2004 WL 1627337, at *2 (Mass. Land Ct. July 21, 2004) (the need to evaluate bias and credibility of the plaintiff weighs against holding litigation finance documents confidential).

[147] *See* Leslie Perrin, *England and Wales*, *in* THE THIRD PARTY LITIGATION FUNDING LAW REVIEW 48, 48-58 (Leslie Perrin ed., 2d ed. 2018) (reviewing litigation financing in England and Wales); Nicholas Dietsch, Note, *Litigation Financing in the U.S., the U.K., and Australia: How the Industry Has Evolved in Three Countries*, 38 N. KY. L. REV. 687, 698-705 (2011); Jasminka Kalajdzic et al., *Justice for Profit: A Comparative Analysis of Australian, Canadian and U.S. Third Party Litigation Funding*, 61 AM. J. COMP. L. 93, 96-113 (2013); Maya Steinitz, *Whose Claim Is This Anyway? Third-Party Litigation Funding*, 95 MINN. L. REV. 1268, 1275-86 (2011) [hereinafter *Whose Claim Is This Anyway?*]). *See generally* LISA BENCH NIEUWVELD & VICTORIA SHANNON SAHANI, THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION (2d. ed. 2017) (detailing third-party litigation funding in several countries and discussing the problems that may arise with litigation funding in international arbitration).

consensus that arbitrators have the authority to order such disclosure. But, likely due to the controversial nature of disclosure, the report refrains from "provid[ing] any new standards for assessing conflicts, but instead refers such issues to existing law, rules, and guidelines."[148] Arbitrators, thus, are left to decide on their own whether, to what extent, and under what conditions, further disclosure may be warranted.

In Australia, the first jurisdiction to legalize (indeed—actively foster) litigation finance, the existence of a litigation finance agreement needs to be disclosed, but the details of the agreement are likely privileged.[149] And in the United Kingdom, the existence of a litigation finance agreement and the identity of the litigation funder are not considered privileged information but the details of a litigation finance agreement generally are.[150]

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What pending proposals generally have in common is that, when they do not simply punt on the issue, they seek or assume bright-line rules on disclosure. The rest of the Essay questions this approach.

II. THE STAKES: WHY LITIGATION FINANCE IS UNDERSTOOD TO BE THE MOST IMPORTANT DEVELOPMENT IN CONTEMPORARY CIVIL LITIGATION

Critics and proponents alike agree that the rise of litigation finance in recent years is the single most important development in civil justice.[151] The following

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[148] *See* INT'L COUNCIL FOR COMMERCIAL ARBITRATION, REPORT OF THE ICCA-QUEEN MARY TASK FORCE ON THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION 12 (2018), https://www.arbitration-icca.org/media/10/40280243154551/icca_reports_4_tpf_final_for_print_5_april.pdf.

[149] *See* Jason Geisker & Jenny Tallis, *Australia*, *in* THE THIRD PARTY LITIGATION FUNDING LAW REVIEW, *supra* note 147, at 1-11.

[150] *See* Perrin, *supra* note 147, at 53.

[151] *See, e.g.*, GEOFFREY MCGOVERN ET AL., THIRD PARTY LITIGATION FUNDING AND CLAIM TRANSFER 1 (2010) (ebook). More generally, "[w]e find ourselves in the second stage of a revolution in the financing of civil litigation . . . [c]ompared with the situation seventy-five years ago, the plaintiffs' bar is today better financed, both absolutely and relative to the defense bar." Stephen C. Yeazell, *Re-Financing Civil Litigation*, 51 DEPAUL L. REV. 183, 183 (2011). Critics include the U.S. Chamber of Commerce, through its publications. *See, e.g.*, JOHN BEISNER ET AL., U.S. CHAMBER INST. FOR LEGAL REFORM, SELLING LAWSUITS, BUYING TROUBLE: THIRD-PARTY LITIGATION FUNDING IN THE UNITED STATES (2009),

paragraphs explain the main reasons the practice is so profoundly important and why it has generated so much interest among academics, lawyers, legislatures, the judiciary, the media, and the investment community.

A. Litigation Finance Implicates Foundational Questions of Civil Justice

The primary import of the industry is its propensity to increase the number of cases brought. This is either a positive or a negative depending on whether one focuses on the potential to increase access to justice for deserving but under-resourced plaintiffs, or on the potential to increase non-meritorious litigation.[152]

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https://www.instituteforlegalreform.com/uploads/sites/1/thirdparty litigationfinancing.pdf; BEISNER & RUBIN, *supra* note 127, at 1 (labeling litigation finance "a clear and present danger to the impartial and efficient administration of civil justice in the United States"); *Third Party Litigation Funding*, U.S. CHAMBER INST. FOR LEGAL REFORM, https://instituteforlegalreform.com/issues/third-party-litigation-funding (last visited Sept. 8, 2019) [hereinafter *Third Party Litigation Funding*]. Other critics include Jeremy Kidd, *To Fund or Not to Fund: The Need for Second-Best Solutions to the Litigation Finance Dilemma*, 8 J.L. ECON. & POL'Y 613 (2012) and Joanna M. Shepherd, *Ideal Versus Reality in Third-Party Litigation Financing*, 8 J.L. ECON. & POL'Y 593 (2012). Proponents include ABA Comm. on Ethics & Prof'l Responsibility, *see* Formal Opinion 484 (Nov. 27, 2018), N.Y. State Bar Ass'n Comm. on Prof'l Ethics, *see* Ethics Opinion 1104 (Nov. 15, 2016), and scores of scholars, *see, e.g.*, Susan Lorde Martin, *Litigation Financing: Another Subprime Industry That Has a Place in the United States Market*, 53 VILL. L. REV. 83 (2008); Susan Lorde Martin, *The Litigation Financing Industry: The Wild West of Finance Should Be Tamed Not Outlawed*, 10 FORDHAM J. CORP. & FIN. L. 55 (2004); Julia H. McLaughlin, *Litigation Funding: Charting a Legal and Ethical Course*, 31 VT. L. REV. 615 (2007); Jonathan T. Molot, *Litigation Finance: A Market Solution to a Procedural Problem*, 99 GEO. L.J. 65 (2010); Richard W. Painter, *Litigating on a Contingency: A Monopoly of Champions or a Market for Champerty?*, 71 CHI.-KENT L. REV. 625 (1995); Sebok, *Litigation Investment and Legal Ethics*, *supra* note 141, at 111.

[152] For arguments that litigation finance is likely to increase non-meritorious litigation, see, for example, Jeremy Kidd, *Modeling the Likely Effects of Litigation Financing*, 47 LOY. U. CHI. L.J. 1239, 1258-60 (2016); Thomas J. Donohue, *Stopping the Litigation Machine*, U.S. CHAMBER OF COMM. (Oct. 31, 2016, 9:00 AM), https://www.uschamber.com/series/your-corner/stopping-the-litigation-machine; and *Third Party Litigation Funding*, *supra* note 151. For arguments that litigation is unlikely to increase non-meritorious litigation, see, for example, Molot, *supra* note 151, at 106-07; Shannon, *supra* note 141, at 874-75. More generally, for literature on the socially desirable level of litigation, see, for example, Richard L. Abel, *The Real Tort Crisis — Too Few Claims*, 48 OHIO ST. L.J. 443 (1987) and Nora Freeman Engstrom, *ISO the Missing Plaintiff*, JOTWELL (Apr. 12, 2017), https://torts.jotwell.com/iso-the-missing-plaintiff/ (book review) ("Using a number of methodologies, these researchers have, again and again, confirmed Abel's basic empirical premise. In most areas of the tort law ecosystem, only a small fraction of Americans seek compensation, even following negligently inflicted injury."). For a classic law and economics analysis of the suboptimal levels of litigation, see Steven Shavell, *The Fundamental Divergence Between the Private and the Social Motive to Use the Legal System*, 26 J. LEGAL STUD. 575 (1997); Nora Freeman Engstrom, *Re-Re-Financing Civil Litigation:*

An associated concern, relating to systemic effects on the courts, is what affects the availability of funding and liquidity of legal claims might have on how quickly cases settle.[153] But peel away this level of the debate and other, possibly even more profound, implications arise.

B. Constitutional, Human Rights, and Civil Rights Implications

The ability to bring a suit—an expensive enterprise under the best of circumstances—implicates constitutional, human, and civil rights. Access to justice is a human right, "guaranteed as a legal right in virtually all universal and regional human rights instruments, since the 1948 Universal Declaration, as well as in many national constitutions."[154] In the United States, the right to bring a suit is often further described as a form of free speech and participation in certain types of cases is understood to be an aspect of democratic participation.[155]

How Lawyer Lending Might Remake the American Litigation Landscape, Again, 61 UCLA L. REV. DISCOURSE 110 (2013) (describing the evolution of funding available to plaintiff-side personal injury firms and identifying the ways in which third party funders in this space may alter the American litigation landscape).

[153] *See* Steinitz, *Whose Claim Is This Anyway?*, *supra* note 147, at 1305-07. For empirical data on the subject, see Ronen Avraham & Anthony Sebok, *An Empirical Investigation of Third Party Consumer-Litigant Funding* 13 (Cardozo Legal Studies Research Paper No. 539, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3137247 (using a dataset of funding requests to find that in cases where the plaintiff was funded and the lawsuit was settled, 417 days was the median amount of time between the initial payment to the funder and settlement of the case and the funder being fully paid); David S. Abrams & Daniel L. Chen, *A Market for Justice: A First Empirical Look at Third Party Litigation Funding*, 15 U. PA. J. BUS. L. 1075, 1080-81, 1107 (2013) (finding that although data on settlements cannot be obtained, "that once defendants recognize the increased likelihood of litigation and the greater resources held by plaintiffs, they would be more likely to settle in equilibrium. While transitioning to that new equilibrium, there is another potential benefit from litigation funding: earlier resolution of the law."); Ronen Avraham & Abraham Wickelgren, *Third-Party Litigation Funding — A Signaling Model*, 63 DEPAUL L. REV. 233, 235 (2014) (arguing that third-party litigation funding gives plaintiff(s) more time to come to a better settlement); Daniel L. Chen, *Can Markets Stimulate Rights? On the Alienability of Legal Claims*, 46 RAND J. ECON. 23, 49 (2015) ("[I]ncreased settlement may arise if litigation funding reduces the uncertainty of case outcomes. . . . Although settlement is not directly measured . . . the number of cases filed and the number of finalizations are positively associated with litigation funding, whereas the number of times parties are required to appear before court per case is negatively associated with litigation funding . . . .").

[154] Francesco Francioni, *The Rights of Access to Justice Under Customary International Law*, *in* ACCESS TO JUSTICE AS A HUMAN RIGHT 1, 2 (Francesco Francioni ed., 2007).

[155] *See, e.g.*, Alexandra D. Lahav, *Bellwether Trials*, 76 GEO. WASH. L. REV. 576, 577-79 (2008) (arguing that trials further certain social and democratic aims such as giving a voice

Tellingly, the last time a vigorous debate erupted around "champerty" and "maintenance"—the traditional doctrines that barred, with some exceptions, the funding of a suit by a nonparty—was when civil rights organizations took on civil rights cases, including school integration cases, pro bono.[156]

And for defendants, the questions of who funds the plaintiffs' case, the motivation behind the funding, and whether or not the defendants get to request discovery from the funders or, even, join them as parties, are often framed as questions of defendants' due process rights.

C. Implication for the Organizational Structure of Law Firms and the Competition for Legal Services

Litigation finance, especially with the very recent advent of "portfolio funding"—funding tied to the performance of a portfolio of cases, rather than that of a single case, and provided directly to law firms[157]—is changing the competitive landscape of law firms and is poised to change the organization, governance, and finance of law firms.[158] For example, start-up and boutique firms are now able to effectively compete with so-called BigLaw and with established plaintiffs' firms for high-end work, including work that may require investment by the firm (e.g., contingency and *qui tam* cases). The availability of outside financing also vitiates the traditional workaround, developed when law firms had a monopoly over litigation finance, whereby law firms created consortia of firms, where only one or some provides lawyering, and the others were brought on board solely to provide

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to litigants to express their claims and providing a platform for the publication of wrongs that may have been incurred).

[156] *See The South's Amended Barratry Laws: An Attempt to End Group Pressure Through the Courts*, 72 YALE L.J. 1613, 1613 (1963).

[157] *See As the Funding Industry Evolves, Portfolio Financing Grows in Popularity*, BENTHAM IMF: BLOG (May 10, 2018), https://www.benthamimf.com/blog/blog-full-post/bentham-imf-blog/2018/05/10/as-the-funding-industry-evolves-portfolio-financing-grows-in-popularity [https://perma.cc/53U7-CHB4]; Press Release, Burford, Burford Capital Announces Innovative Insolvency Portfolio Financing with Grant Thornton (May 4, 2016), http://www.burfordcapital.com/newsroom/burford-capital-announces-innovative-insolvency-portfolio-financing-grant-thornton; *Portfolio Litigation Funding*, WOODSFORD LITIG. FUNDING, https://woodsfordlitigationfunding.com/litigation-finance/portfolio-litigation-funding (last visited Feb. 18, 2018) [https://perma.cc/E3YK-YN53].

[158] For an in-depth discussion of these effects, see Maya Steinitz, The Partnership Mystique: Law Firm Finance and Governance in the 21st Century (forthcoming manuscript) (on file with author).

financing.[159] These changes will have cascading effects on how law firms finance and govern themselves.

D. Spillover Effects to Criminal Defense Finance

The financing of civil litigation, especially the modalities it takes, appears to have inspired modes of criminal defense funding. For example, following the development of the crowdfunding of litigation funding,[160] criminal defendants have followed suit with similar crowdfunding efforts.[161] And one may surmise that through sensitizing the public to litigation funding, with its attendant host of conflicts and other ethical challenges, in the civil justice arena, conflicts-ridden modes of funding in the criminal defense realm may become more palatable than they otherwise would have been.[162]

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[159] *See* Marc Galanter, *Anyone Can Fall Down a Manhole: The Contingency Fee and Its Discontents*, 47 DEPAUL L. REV. 457, 475-76 (1998); Marc Galanter, *Case Congregations and Their Careers*, 24 LAW & SOC'Y REV. 371, 387 (1990).

[160] *See infra* note 230.

[161] Prominent current examples include Michael Cohen, Benjamin Netanyahu, and Rick Gates. *See Michael Cohen Truth Fund*, GOFUNDME (Aug. 21, 2018), https://www.gofundme.com/hqjupj-michael-cohen-truth-fund; *Netanyahu Rejects Decision Banning Tycoons from Funding His Legal Defense*, TIMES OF ISRAEL (Feb. 24, 2019, 9:16 PM), https://www.timesofisrael.com/netanyahu-rejects-decision-banning-tycoons-from-funding-his-legal-defense ("Legal representatives for Prime Minister Benjamin Netanyahu declared Sunday that the premier does not intend to accept a decision banning funding from wealthy associates of his legal defense in the three corruption cases he is facing."); Kathryn Watson, *Judge Chastises Rick Gates for Legal Defense Fundraiser Video*, CBS NEWS (Dec. 22, 2017, 1:01 PM), https://www.cbsnews.com/news/judge-chastises-rick-gates-for-legal-defense-fundraiser.

[162] For examples of such controversial, potentially conflicts-ridden, forms of criminal defense finance by President Trump with respect to the legal bills of his family members and former and current staffers, see Summer Meza, *Trump's New Conflict of Interest Could Involve Paying Off Officials to Not Talk About Russia*, NEWSWEEK (Nov. 18, 2017, 9:33 AM), https://www.newsweek.com/trump-legal-fees-staffers-conflict-interest-715995 ("[R]ather than using campaign donations or charging the Republican National Committee, [President Trump] has created a fund to finance the legal bills of his former and current staffers — which could violate ethics laws if there's a chance it could influence their testimonies. . . . The RNC paid more than $230,000 for two of Trump's personal attorneys . . . . The Republican Party has shelled out even more for Donald Trump Jr., paying more than $500,000 in legal fees as he faces allegations of collusion . . . .").

The urgency of all of these questions is amplified when one considers the explosive growth of the industry in recent years, both nationally and globally, and the projections of further future growth as well as expansion into new areas.

Third-party funding, which until the beginning of this century was considered near-universally as a crime, a tort, or at least an ethical violation, has erupted into the mainstream and some estimates of the size of this global industry now place its market capitalization at $50-$100 billion.[163] Given the growing awareness of litigation finance, the fact that many areas of litigation, such as class and mass actions in the United States, have not yet been unlocked as "asset sub-classes," and the fact that various jurisdictions have only recently or not yet legalized the practice—by all estimates, litigation finance is poised to continue seeing robust growth in coming years.[164] This brings us to our next topic: the variability of litigation finance scenarios.

III. THE VARIABILITY OF LITIGATION FINANCE SCENARIOS

When assessing the suitability of the approaches currently contemplated, as outlined in Part I, it is important to understand the wide array of practices that fall under the rubric of "litigation finance" and the colorful cast of characters that are involved. Ultimately, the variability of litigation finance scenarios militates against a bright-line rule approach.

In 2016, litigation finance exploded into the public consciousness when billionaire Peter Thiel's funding of Hulk Hogan's lawsuit against Gawker became

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[163] *See* Baker, *supra* note 111. Of course, since almost all funders are privately-held, and since substantial numbers of financings are provided by ad hoc funders, not dedicated litigation financiers, definitive numbers are unavailable.

[164] *See, e.g.*, MAYA STEINITZ, THE CASE FOR AN INTERNATIONAL COURT OF CIVIL JUSTICE 127-130 (2019) (discussing the rise of litigation finance and its growing prominence); Cassandra Burke Robertson, *The Impact of Third-Party Financing on Transnational Litigation*, 44 CASE W. RES. J. INT'L L. 159, 164-68 (2011) (discussing the growing global scale of litigation finance in jurisdictions such as Australia and England, and how countries such as Spain and Brazil offer untapped markets for third-party funding); Christopher P. Bogart, *What's Ahead in Litigation Finance?*, BURFORD: BLOG (July 17, 2017), http://www.burfordcapital.com/blog/future-litigation-finance-trends [https://perma.cc/3P8Q-RPD3] (arguing that litigation finance will experience robust growth in the coming years); *Litigation Finance Forecast: Six Trends to Watch in 2019*, BENTHAM IMF: BLOG (Jan. 2, 2019), https://www.benthamimf.com/blog/blog-full-post/bentham-imf-blog/2019/01/02/litigation-finance-forecast-six-trends-to-watch-in-2019 [https://perma.cc/2KPG-BAA5] (predicting a surge in portfolio financing to fund more large-scale litigation).

public. Mr. Hogan (whose legal name is Terry Bollea), a retired professional wrestler, sued Gawker for, *inter alia*, invasion of privacy for publishing a video showing him having sex with a friend's wife.[165] In May 2016, reports surfaced that Mr. Thiel, a Silicon Valley mogul, funded the case. Reporting suggested, specifically, that he did so in order to satisfy a personal vendetta: Gawker had "outed" him as gay a decade earlier.[166] Bankrolling Hogan's claim was, according to news reports, his "revenge."[167] Revenge is indeed a dish best served cold: careful canvassing for a "good" plaintiff ultimately yielded a $140 million judgment in favor of Mr. Hogan. The large judgment pushed Gawker into bankruptcy.[168]

Because the funding in this case felled a news outlet, journalistic interest was heightened and the case generated significant coverage in the press which, in turn, led to increased calls to regulate the nascent but fast-growing litigation finance industry.[169] Specifically, the case drew attention to the issue of whether the

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[165] *See* Bollea v. Gawker Media, LLC, No. 8:12-cv-02348-T-27TBM, 2012 WL 5509624, at *2 (M.D. Fla. Nov. 14, 2012).

[166] *See* Eugene Kontorovich, *Peter Thiel's Funding of Hulk Hogan-Gawker Litigation Should Not Raise Concerns*, WASH. POST: THE VOLOKH CONSPIRACY (May 26, 2016, 5:19 AM), https://www.washingtonpost.com/news/volokh-conspiracy/wp/2016/05/26/peter-thiels-funding-of-hulk-hogan-gawker-litigation-should-not-raise-concerns/; Andrew Ross Sorkin, *Peter Thiel, Tech Billionaire, Reveals Secret War with Gawker*, N.Y. TIMES (May 25, 2016),https://www.nytimes.com/2016/05/26/business/dealbook/peter-thiel-tech-billionaire-reveals-secret-war-with-gawker.html.

[167] Manuel Roig-Franzia, *What Happens When Billionaires Battle Gossipmongers? Prepare for Explosions*, WASH. POST (Feb. 9, 2019, 4:00 AM), https://www.washingtonpost.com/lifestyle/style/what-happens-when-billionaires-battle-gossipmongers-prepare-for-explosions/2019/02/08/bb475576-2be8-11e9-b011-d8500644dc98_story.html. Thiel told the New York Times, "It's less about revenge and more about specific deterrence . . . . I saw Gawker pioneer a unique and incredibly damaging way of getting attention by bullying people even when there was no connection with the public interest." Sorkin, *supra* note 166.

[168] Gawker filed for bankruptcy on June 10, 2016. *See* In re Gawker Media LLC, 571 B.R. 612, 617 (Bankr. S.D.N.Y. 2017); *see also* Matt Drange, *Peter Thiel's War on Gawker: A Timeline*, FORBES (June 21, 2016, 1:22 PM), http://www.forbes.com/sites/mattdrange/2016/06/21/peter-thiels-war-on-gawker-a-timeline/#181ed4b17e80.

[169] *See, e.g.*, Michelle Castillo, *Gawker to Pay Hulk Hogan at Least $31 Million to Settle Case*, CNBC (Nov. 8, 2016, 2:42 PM), https://www.cnbc.com/2016/11/02/gawker-settling-litigation-with-peter-thiel-hulk-hogan-for-undisclosed-amount.html (noting the founder of Gawker's thoughts on the legacy of the Gawker-Hogan litigation and the potential danger of "dark money" in litigation finance); Sorkin, *supra* note 166 (discussing the increased journalistic interest in third party funding); Martha C. White, *Peter Thiel vs. Gawker: Case Highlights World of 'Litigation Funding'*, NBC NEWS (May 29, 2016, 7:37 AM), https://www.nbcnews.com/business/business-news/peter-thiel-vs-gawker-case-highlights-world-litigation-funding-n581726 (discussing the growing practice of litigation finance).

existence of funding agreements, the terms of any agreement, and/or the identity of any funders should be public information.[170]

To add complexity and intrigue to this example, according to Forbes magazine, Gawker executives "agree[d] to sell a minority stake in the company to Russian billionaire Viktor Vekselberg and his company . . . . [T]he money was used, in part, to defend itself from ongoing litigation."[171] In other words, litigation finance was utilized on both sides of the 'v.' with questionable funding sources and motivations on both cases.

Other ripped-from-the-headlines examples of funded litigations include Stormy Daniels' crowdfunded litigation;[172] the NFL concussion cases;[173] and #MeToo cases.[174] Predatory lending practices on the consumer litigation finance part of the industry, often deployed when individuals of limited means have suffered a bodily injury and are seeking to finance personal injury cases, have also been in the news.[175] In the international and transnational realm, attention grabbers include funding in the bet-the-company and bet-the-region mass torts litigation between thousands of Ecuadorian residents of the Amazon and the oil

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[170] This statement is based on more than a dozen calls from journalists received by the author in connection with the disclosure of the Thiel financing of the Hulk's case against Gawker.

[171] Drange, *supra* note 168; *see* Tom Winter & Robert Windrem, *Who Is Viktor Vekselberg, the Russian Oligarch Linked to Trump Lawyer Michael Cohen?*, NBC NEWS (May 10, 2018, 6:22 AM), https://www.nbcnews.com/politics/donald-trump/meet-nice-russian-oligarch-linked-trump-lawyer-michael-cohen-n872716 (explaining that Vekselberg is possibly linked to money that has moved through companies he is associated with to Michael Cohen, President Trump's former personal lawyer and a convicted felon, and potentially paid to Stormy Daniels).

[172] *See* Stephanie Clifford, *Clifford (aka Daniels) v. Trump et al.*, CROWDJUSTICE (Apr. 24, 2018), https://www.crowdjustice.com/case/stormy.

[173] *See* Steven M. Sellers, *Troubled NFL Concussion Deal May Roil NHL Cases*, BLOOMBERG LAW (May 25, 2018, 4:06 AM), https://news.bloomberglaw.com/product-liability-and-toxics-law/troubled-nfl-concussion-deal-may-roil-nhl-cases.

[174] *See* Matthew Goldstein & Jessica Silver-Greenberg, *How the Finance Industry Is Trying to Cash In on #MeToo*, N.Y. TIMES (Jan. 28, 2018), https://www.nytimes.com/2018/01/28/business/metoo-finance-lawsuits-harassment.html; Philippe A. Lebel, *Could a Litigation Finance Initiative Capitalize on #MeToo?*, NAT'L L. REV. (Nov. 14, 2017), https://www.natlawreview.com/article/could-litigation-finance-initiative-capitalize-metoo.

[175] *See, e.g.*, Matthew Goldstein, *Judge Dismisses Federal Suit Accusing Firm of Defrauding 9/11 Responders*, N.Y. TIMES (Sept. 12, 2018), https://www.nytimes.com/2018/09/12/ business/september-11-attacks-nfl-concussion-settlements.html (discussing the practice of extending cash advances to people with pending cases such as 9/11 responders).

giant Chevron,[176] and the atypical, nonprofit funding by the Anti-Tobacco Trade Litigation Fund, created by Bloomberg Philanthropies and the Bill and Melinda Gates Foundation, which funded low- and middle-income countries that were defendants in the international investment arbitration against tobacco companies that claimed that regulations requiring plain packaging of tobacco products violated their rights under investment treaties.[177] A domestic corollary can be seen in the funding by Iowa agricultural groups of the defense of three state counties against pollution charges, through the following non-transparent structure:

> In March of 2016, documents revealed . . . that agricultural groups—including the Iowa Farm Bureau Federation, the Iowa Soybean Association, the Iowa Corn Growers Association (ICGA) and the Iowa Drainage District Association—secretly funded the defense of the Iowa lawsuit through a 501(c)3 nonprofit, the Agricultural Legal Defense Fund. According to Internal Revenue Service documents . . . fertilizer and other agricultural company officials make up the bulk of the nonprofit's officers and directors, including representatives from Smith Fertilizer, Monsanto Co., Growmark, Cargill, Koch Agronomics, DuPont Pioneer and the United Services Association.[178]

The list goes on and on, but these examples are sufficient to illustrate the key point upon which this Part will elaborate: the range of funding scenarios is vast and its vastness and variability is, arguably, the main reason those drafting proposed disclosure rules find it hard to settle on a noncontroversial formula. For

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[176] *See* Chevron Corp. v. Donziger, 833 F.3d 74, 134 (2d Cir. 2016); Steinitz, *The Litigation Finance Contract*, *supra* note 141, at 465-79.

[177] *See* Philip Morris Brands Sàrl v. Oriental Republic of Uru., ICSID Case No. ARB/10/7, Award, ¶¶ 12, 22 (July 8, 2016). For an explanation of third-party funding in that case as well as other forms of third-party funding of investment arbitration, see Victoria Shannon Sahani, *Revealing Not-for-Profit Third-Party Funders in Investment Arbitration*, OXFORD U. PRESS (Mar. 1, 2017), http://oxia.ouplaw.com/page/third-party-funders [https://perma.cc/LFF9-ML4K].

[178] Llewellyn Hinkes-Jones, *Open Records Request Exposes Rare Litigation Finance Document*, BLOOMBERG LAW (Feb. 23, 2017), https://www.bloomberglaw.com/product/blaw/document/X2CUA2PO000000 [https://web.archive.org/web/20170223223237/https://www.bna.com/iowa-pollution-suit-n57982084227/]. The report goes on to quote Michael Reck, an attorney with Belin McCormick P.C. in Des Moines, Iowa, one of the law firms representing the counties, as stating that such finance agreements are "not uncommon." *Id.*

example, our legal system arguably should treat providing access to justice very differently than it does using the courts as a vehicle for revenge. Similarly, as already acknowledged, average Joes and Janes should receive more protection (which may require disclosure to courts) than do sophisticated funded parties. And foreign governments and their agents acting as financiers may require a different level of scrutiny than a commercial entity, especially if the cases they invest in have national security or foreign relations implications.

Similarly, companies funding cases against their competitors should be treated differently than professional funding firms funding similar cases for a monetary profit. Politically-motivated funding, while distasteful to many, should be considered in light of First Amendment concerns not necessarily present in other types of cases. The consideration for disclosure in arbitration—generally a confidential forum but also one where the decision-makers are selected *ad hoc* by parties (i.e., do not have life tenure)—are different from courts which, in rule of law societies, are transparent and wherein judges are not jostling for their next appointment. And it appears as though the public may regard a news outlet as different from other types of defendants, especially if the litigation threatens to drive it out of business.

In other words, variables such as the motivation and likely effects of the funding, type of funder, type of funded party, type of defendant, subject matter of the case, and forum all matter. Further, simply classifying the funding by type does not dispose of the inquiry as to what type of and how much disclosure, if any, is appropriate. For example, arbitrators, who usually have a private practice and serve clients when they're not serving on a tribunal, may be more likely to have a conflict of interest than are judges, pointing in the direction of more disclosure in arbitration. However, arbitrators, unlike judges, are not empowered to protect the general public and are not expected or empowered to consider policy implications to the same extent as judges are, pointing in the direction of less disclosure.

And here is another example of the context-specificity needed. Even in international arbitration, one size does not fit all: the funding of a commercial claim brought by a commercial party does not, on its face, suggest transparency of funding is warranted. But the funding of an international arbitration involving, say, a boundary dispute or exploration rights does call for transparency as to who is pulling the purse strings because of the public interest involved in such matters. Finally, and again an example from international arbitration, at the beginning of the process disclosure of the identity of the funder aimed only at the tribunal may be all that is needed for conflicts check purposes. Conversely, at the end of a case when a panel needs to decide whether and to what extent to shift the cost of the proceeding to the losing party, disclosure of the funding terms to both the tribunal and opposing party may be warranted.[179]

The dizzying array of variables and variations suggests that: (i) judges and arbitrators should be empowered to inquire into funding and; (ii) the extent and form of this important inquiry should be left to the discretion of the individual decision-maker so she can engage in a thoughtful weighing of the intricate considerations as they pertain to the facts before her. The next Part brings the analysis full circle with a proposed balancing test.

IV. THE PROPOSAL: A BALANCING TEST

To properly account for the role of litigation finance in proceedings before them, judges and arbitrators should be given broad discretion to undertake a contextual analysis and should not be hamstrung by the kinds of all-or-nothing or otherwise bright-line rules currently contemplated. Nor, however, should they be left totally without guidance, even though, at present, it is understood that decision-makers such as judges or arbitrators have the authority to order disclosure. In short, the proper approach to the question of whether and what to disclose is a balancing test.

To simplify a vast debate in legal philosophy,[180] the distinction between rules and standards is as follows. "Rules" are rigid and constraining: "Once a rule has been interpreted and the facts have been found, then the application of the rule to

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[179] *See* INT'L COUNCIL FOR COMMERCIAL ARBITRATION, *supra* note 148, at 159.

[180] For jurisprudential classics on the rules/standards distinction and its implications, see, for example, H.L.A. HART, THE CONCEPT OF LAW 126-31 (1961); ROSCOE POUND, AN INTRODUCTION TO THE PHILOSOPHY OF LAW 115-23 (1922); FREDERICK SCHAUER, PLAYING BY THE RULES: A PHILOSOPHICAL EXAMINATION OF RULE-BASED DECISION-MAKING IN LAW AND IN LIFE 10-12 (1991); Ronald M. Dworkin, *The Model of Rules*, 35 U. CHI. L. REV. 14, 22-29 (1967); Duncan Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685, 1687-1701 (1976). For examples of treatment of the distinction and its consequences from the law and economic tradition, see, for example, Colin S. Diver, *The Optimal Precision of Administrative Rules*, 93 YALE L.J. 65 (1983); Isaac Ehrlich & Richard A. Posner, *An Economic Analysis of Legal Rulemaking*, 3 J. LEGAL STUD. 257 (1974); Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557 (1992).

the facts decides the issue to which it is relevant."[181] Conversely, standards provide *discretion*. They seek to guide rather than dictate an outcome. To illustrate:

> Oliver Wendell Holmes and Benjamin Cardozo find themselves on opposite sides of a railroad crossing dispute. They disagree about what standard of conduct should define the obligations of a driver who comes to an unguarded railroad crossing. Holmes offers a rule: The driver must stop and look. Cardozo rejects the rule and instead offers a standard: The driver must act with reasonable caution.[182]

There are tradeoffs when choosing one approach over the other, but a standard is ultimately preferable to a rule in this context. The main advantage of rules is their predictability. The main advantage of standards is fairness through context-specificity. This is so because rules give law content *ex ante* whereas standards do so *ex post*.[183] Further, "[r]ules typically are more costly than standards to create, whereas standards tend to be more costly for individuals to interpret when deciding how to act and for an adjudicator to apply to past conduct . . . . [W]hen individuals can determine the application of rules to their contemplated acts more cheaply, conduct is more likely to reflect the content of previously promulgated rules than of standards that will be given content only after individuals act."[184] A standard, therefore, will provide less guidance to litigation financiers, attorneys, and parties than a rule would and, in that sense, could create costly uncertainty. The lack of a rule could even allow for undesirable behavior as actors explore, through trial (no pun intended) and error, what is and is not permissible.

Notwithstanding the costs of uncertainty and potentially undesirable behavior, a standard is the right approach to litigation finance disclosure because the sector and its best practices are still evolving and, more importantly, because no single

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[181] Lawrence Solum, *Legal Theory Lexicon: Rules, Standards, and Principles*, LEGAL THEORY BLOG (Sept. 6, 2009, 9:40 AM), http://lsolum.typepad.com/legaltheory/2009/09/legal-theory-lexicon-rules-standards-and-principles.html [https://perma.cc/8EF4-SXLV]. Solum, like others, distinguishes between standards and principles but, for simplicity, I will follow Dworkin and limit the distinction to rules and standards. *See* Dworkin, *supra* note 180, at 22-29.

[182] Pierre Schlag, *Rules and Standards*, 33 UCLA L. REV. 379, 379 (1985) (footnotes omitted).

[183] *See* Kaplow, *supra* note 180, at 559-60.

[184] *Id.* at 557.

rule would be able to encompass the vast array of scenarios falling under the increasingly stretched definition of litigation finance. What rule, for instance, could adequately account for the difference between a corporate plaintiff whose legal costs are partially covered by a sophisticated investor who has arranged with the corporation's law firm to fund a portfolio of cases, on the one hand, and, on the other, a fired factory worker whose civil rights case is funded by a small startup focused on algorithm-driven investments in claims worth under one million dollars? And yet both of those are examples of litigation funding.

In the following Section I argue, more specifically, for a particular kind of standard: the balancing test. The reason for this recommendation is that "[i]n almost all conflicts . . . there is something to be said in favor of two or more outcomes. Whatever result is chosen, someone will be advantaged and someone will be disadvantaged; some policy will be promoted at the expense of some other."[185] A balancing test thus recognizes that, normatively speaking, litigation funding is, *ex ante*, neither "good" nor "bad" nor is its regulation (here, in the form of disclosure) "good" or "bad." It is context specific. This pragmatism, inherent to the judicial activity of balancing, is the reason why, while this legal technique has its detractors,[186] "[b]alancing tests are ubiquitous in American law. From the Due Process Clause to the Freedom of Speech and from the federal joinder rules to personal jurisdiction, U.S. law makes the outcome of legal disputes dependent on the balancing of various *interests* and *factors*."[187]

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[185] Arthur Allen Leff, *The Leff Dictionary of Law: A Fragment*, 94 Yale L.J. 1855, 2123 (1985). For an in-depth discussion of the benefits and perils of balancing tests, see, for example, T. Alexander Aleinikoff, *Constitutional Law in the Age of Balancing*, 96 YALE L.J. 943, 943-44, 965-66 (1987) (discussing these modes of judicial decision making in the context of constitutional law). Litigation finance, *inter alia*, intertwines with the constitutional values of the right to have one's day in court and of due process.

[186] *See* Patrick M. McFadden, *The Balancing Test*, 29 B.C. L. REV. 585, 636-49 (1988). *See generally* Aleinikoff, *supra* note 185 (discussing the rise in use of balancing tests and giving various critiques of balancing).

[187] Lawrence Solum, *Legal Theory Lexicon: Balancing Tests*, LEGAL THEORY BLOG (Dec. 10, 2017, 5:37 PM) (emphasis added), http://lsolum.typepad.com/legaltheory/2017/12/legal-theory-lexicon-balancing-tests.html [https://perma.cc/8AGY-WUQW].

A. The Proposed Balancing Test

In this Section, I will first outline the important interests of the public and of the parties at stake in litigation finance. Then, I will map those interests onto a series of concrete factors that judges and arbitrators should consider when deciding on disclosure.[188]

1. Interests

Whether and how a litigation is funded implicates public and private interests.[189] Specifically, the public has an interest in such matters as access to justice, the development of the law, the cost of civil justice, the level of litigation in society, whether systemically the "Haves" come out ahead in litigation, the length of time litigation takes, the extent of discovery the parties can afford/inflict, and the purposes for which the public good that is the justice system is being used (e.g., justice, compensation, third party profits, revenge, politics, policy, and so forth).[190] A special subset of public interest is the interests of the forum itself (usually, judicial economy). However, because the manner in which effects on the courts often feature in policy debates surrounding litigation finance, and due to the prevalence of arbitration which raises a separate set of concerns, I treat forum interests as a separate category. Finally, the private litigants, both the funded plaintiffs and the defendants who face them, have private interests which must be weighed. Some of those overlap with the public interests mentioned above—plaintiffs, for instance, have a stake in improved access to justice and plaintiffs and defendants both have an interest in efficient proceedings—but others exist

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[188] This is an expansion and an application of a taxonomy I first offered in a previous article. *See* Steinitz, *Whose Claim Is This Anyway?*, *supra* note 147, at 1302-03.

[189] Balancing tests often take the meta structure of balancing public versus private interests with different private and public interests falling under each category depending on the interests. A couple of examples include the balancing test for granting preliminary injunctions and the one for granting dismissal based on forum non conveniens. *See* 11A CHARLES ALAN WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE AND PROCEDURE § 2948.2 (3d ed. 2019); 14D CHARLES ALAN WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE AND PROCEDURE § 3828 (4th ed. 2019).

[190] For a discussion of how repeat players such as funders can affect whether the "Haves" or "Have-nots" come out ahead in litigation, see Steinitz, *Whose Claim Is This Anyway?*, *supra* note 147, at 1299-1302. For a similarly canonical explanation of why there is both too little and too much litigation due to the divergence of private and social incentives to sue, see Shavell, *supra* note 152, at 575-81.

independently. Any test relating to a component of litigation—its finance—should weigh all of these categories of interests.

I will first lay out those interests in more detail, and in the next Section, I will turn to a discussion of how those interests manifest in specific aspects of a litigation (or arbitration) that could be the subject of a decision-maker's attention when contemplating disclosure.

a. Public Interests

That the extremely high cost of litigation puts justice out of reach for most average Joes and Janes is the starting point for many a course in first year civil procedure. The public has an interest in reducing barriers to accessing the courts. Indeed, the global litigation finance industry first took hold in Australia and the United Kingdom when each jurisdiction legalized the practice as part of national access to justice reforms.[191] Disclosure requirements that are too cumbersome may depress the level of available funding, or raise its costs, or both, diminishing the benefits litigation finance contributes to access to justice.[192]

The expense of litigation imposes an additional cost—by increasing the homogeneity of parties it also increases the homogeneity of the issues presented to the courts. This means that some areas of the law get more judicial attention than others and consequently benefit from more iterative and nuanced development. The public has an interest in access to justice generally, but also an independent interest in the development of areas of law that may be less keenly pursued by the deep-pocketed litigants who can best afford to go to court. Litigation finance has the potential to add significant diversity to the pool of those able to afford to litigate, and therefore to increase the diversity of issues before the courts. But it holds the potential to do more than that. In terms of contribution to the development of the law and the question of who gets to affect judicial law-making, namely is it only the "Haves," or do the "Have-nots" get a chance to do so as well?:

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[191] Michael Napier et al., CIVIL JUSTICE COUNCIL, IMPROVED ACCESS TO JUSTICE — FUNDING OPTIONS AND PROPORTIONATE COSTS 54 (2007); RUPERT JACKSON, REVIEW OF CIVIL LITIGATION COSTS: FINAL REPORT 40 (2009), https://www.judiciary.uk/wp-content/uploads/JCO/Documents/Reports/jackson-final-report-140110.pdf.

[192] *See* Avraham & Sebok, *supra* note 153, at 5-6, 30.

> By aligning structurally weak social players who make infrequent use of the courts (one-shotters) with powerful funders who make repeated use of the court system (repeat players), litigation funding may alter the bargaining dynamics between the litigating parties in favor of disempowered parties. It may thereby enable the litigation process to serve as a redistributive tool by society's have-nots as opposed to an (unwitting, perhaps) guardian of the status quo in favor of society's haves. In other words, it may allow these traditionally disempowered parties to "play for rules," i.e., to affect the content of legal rules determined by the courts.[193]

In addition to the general barrier to access to justice imposed by excessively expensive litigation, the high cost of particular parts of the process, especially discovery, opens the door to gamesmanship. The party with more resources has considerable leeway to decide whether, for instance, to "bury" the opposing party with document production or to overwhelm it with discovery requests. Over time, this has contributed to the assessment that the better-resourced party has an undeservedly higher chance of prevailing in any given case. This undermines the strong public interest in having courts that offer a level playing field. Litigation finance can redress that imbalance by equalizing the resources of parties thus making gamesmanship around costs a less effective strategy.

Not all public interests go the way of litigation finance, however. For instance, courts should be a place for the resolution of disputes and not a source of business profit. This is not to say that plaintiffs with legitimate claims should not be able to secure financial settlements or damages awards just because they need to pay financing costs in order to so do. (In this sense, financing litigation is the same as financing education, health care, and so forth through various forms of financing that carry fees). But it does mean that if in any single case, "portfolio" of cases, or category of cases, ultimately most of the recovery goes to the financiers (be they lawyers or third-party funders), rather than to compensate injured parties, deter bad behavior, or otherwise promote the traditional goals of the public good that is the civil justice system, judges can and should be able to take such factors into consideration as they already do, e.g., when supervising class action settlement. And this, in turn, may mean looking into the funding arrangements, including the

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[193] Steinitz, *Whose Claim Is This Anyway?*, *supra* note 147, at 1271-72.

financial terms, and if need be, determining who is the real party in interest in the case.[194]

In the same vein, litigation finance may, in any given case, stretch the already lengthy timeline of litigation. The efficiency of the justice system is of considerable public interest. If financed parties use the resources available to them to draw out a case that might otherwise have been withdrawn or settled, in order to extract more profit, especially when a finance agreement allows a funder to "vote" against settlement, the system risks becoming more inefficient and expensive for everyone. In other countries, especially those with civil law systems, judges have much more discretion than do American judges, constrained as they are by the Seventh Amendment, to throw out a case at almost any stage of the proceedings.[195] The lesser discretion enjoyed in that regard by U.S. judges increases the danger that funded parties and those backing them could impose inefficiencies on the process in their quest for profits.[196]

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[194] In this vein, I have argued elsewhere that consumer litigation funding regulation should ensure that plaintiffs are guaranteed a minimum of 50% recovery of tort claims. *See Lawsuit Lending: Hearing Before the N.Y. State S. Standing Comm. on Consumer Prot.*, (N.Y. 2018) (statement of Maya Steinitz, Visiting Professor of Law at Harvard Law School, Professor of Law at University of Iowa School of Law), https://www.nysenate.gov/transcripts/public-hearing-05-16-18-nys-senate-hearing-consumer-protection-finaltxt. *See generally* Maya Steinitz, *Letter to the Hon. Sen. Orrt (NYS Senate) Regarding Litigation Finance (Lawsuit Lending) (2018)* (Univ. of Iowa Legal Studies Research Paper No. 18-15, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3238148 (arguing for a 50% minimum recovery requirement by addressing both the economics of the requirement and the normative arguments for it).

[195] *See generally* JAMES G. APPLE & ROBERT P. DEYLING, A PRIMER ON THE CIVIL-LAW SYSTEM 26-27 (1995) (outlining differences in the legal process between civil-law judges and American judges).

[196] For an example of a litigation finance agreement that grants control over settlement of consumer cases (low value cases brought on a volume basis), see Mize v. Kai, Inc., No. 17-CV-00915-NYW, 2018 WL 1035084, at *5 (D. Colo. Feb. 23, 2018) and *Carton v. Carroll Ventures, Inc.*, No. CV 17-0037 KG/SCY, 2017 WL 8941281, at *4 (D.N.M. July 10, 2017). Both cases discuss a funding scheme by a funding entity which funded discrimination cases brought under the Americans with Disabilities Act. Under the scheme, the funding agreement purported to limit the plaintiffs' ability to discontinue the litigation or settle without the funder's prior consent as well as to require plaintiffs to settle if so directed by the funder. The funding agreement also had the effect of awarding plaintiffs $50 per case with all other proceeds going to the funder and attorney. For an example of a litigation finance agreement that grants control over settlement of a mass tort case to the funder, see the discussion of the funding in the Chevron-Ecuador environmental mass tort litigation in Steinitz, *The Litigation Finance Contract*, *supra* note 141, at 465-79.

Another, less obvious, element of this analysis is the public interest in data about this brand new, game-changing practice.[197] In the early days of the contingency fee, in the 1920s, the New York City bar and bench grew increasingly worried about contingency fee practices. In 1928, the bar associations for New York City, Manhattan, and the Bronx requested the Appellate Division of the First Judicial Department of the New York Supreme Court to investigate the matter. The Appellate Division entrusted Justice Wasservogel with the task and commissioned a report. The findings of this report led to a recommendation that attorneys be required to file a copy of the retainer agreements between the contingency lawyers and their clients, and an affidavit explaining how the retainer was obtained and affirming that the case had not been solicited by the attorney.[198]

The First Judicial Department implemented some of the report's recommendations, amongst them a requirement that plaintiffs' lawyers file so-called retainer statements that set out the terms of the attorney's compensation. Fast forward to 1955, and Justice Wasservogel was once again commissioned to produce a report on contingent fee practices and consider capping such fees. This second report was based on the retainer statements mandated by the 1929 regulations which were mined and resulted in a finding that 60% of retainers specified that 50% of any recovery went to the lawyers. The ultimate policy outcomes of this second, data-based report were that the First Judicial Department issued regulations that capped contingency fees in actions for personal injury or wrongful death at one-third.[199] The new regulations further required "that lawyers file with the court a 'closing statement' within fifteen days of receiving any money on behalf of a client, whether in judgment or settlement. The closing statement records '[t]he gross amount of the recovery, . . . [t]he taxable costs and disbursements, . . . [t]he net amount of the recovery actually received by

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[197] *See* Eric Helland et al., *Contingent Fee Litigation in New York City*, 70 VAND. L. REV. 1971, 1973-76 (2017) (describing the evolution of the requirement that lawyers in tort cases filed in New York file a copy of their retainer and a closing statement with pertinent information and how the data comprised of such disclosure affected the legislative cap on contingency fees in the state).

[198] *See id.* at 1972-74.

[199] *See id.* at 1974-75. Or a regulatory sliding scale. *See id.* at 1975.

the client, . . . [t]he amount of the compensation actually received or retained by the attorney' . . . ."[200]

In other words, what is now a core tenet of contingency fee practice in personal injury cases (at least in New York), namely a cap on attorney's fees, was a direct outcome of data-gathering and data-based policy-making.[201] The need for data in the context of litigation funding is particularly acute because of a feature of the commercial litigation funding industry universally overlooked in the disclosure debate: funding agreements almost always contain arbitration clauses.[202] This means that the public—be it consumers or legislatures—has no way to understand the reality of the practice and engage in fact-based consumerism, negotiation, and regulation.[203]

With this non-exhaustive list of public interests in place, let us turn to look at some of the private interests at play. Here, too, the discussing is not meant to be exhaustive.

b. Private Interests

The private parties to consider are the litigating parties—including individual plaintiffs, classes, and defendants—and the funders. (As a side note, another potential category of possible private parties whose interest should be weighed, but are beyond the scope of this Essay, are the investors who invest in litigation

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[200] *Id.* at 1975 (quoting the report) (internal quotation marks omitted). These closing statements, in turn, yielded Helland et al.'s article which contains invaluable findings including that "very few cases are resolved by dispositive motions; that litigated cases and settled cases have almost exactly the same average recovery; that median litigation expenses, other than attorney's fees, are 3% of gross recovery; that claims are disproportionately from poor neighborhoods; and that attorneys' fees are almost always one-third of net recovery, which is the maximum allowed by law." *Id.* at 1971.

[201] *See id.* at 1972-76.

[202] This observation is based on the author's extensive experience working with funders, plaintiffs, law firms, and investors, as well as on conversations with funding firms. Exceptions tend to occur only when the funding is provided by an *ad hoc* funder rather than a funding firm, which means that litigation over funding agreements in the courts are based on agreements that are unlikely to be the industry standard.

[203] The lack of data about the industry and its practices was a recurring theme during the public hearing on the regulation of consumer litigation funding held by the New York State Senate Standing Committee on Consumer Protection in May 2018. *See* NY Senate, *Public Hearing - Committee on Consumer Protection - 5/16/18*, YOUTUBE (May 16, 2018), https://www.youtube.com/watch?time_continue=245&v=y2hQNhpVJHk.

finance. These increasingly include pension funds, university endowments, and sovereign wealth funds.[204])

Plaintiffs' interests include access to justice and the wherewithal to withstand the long and expensive process of litigation on the individual case level (as distinct from the overall access to justice and average litigation length public concerns discussed in the previous Section). Plaintiffs' interests also include privacy in relation to their finances. As I like to tell my students to illustrate this last point, whether my mother-in-law is funding my slip-and-fall case and what kind of strings she attaches to such funding has never been considered of relevance in a litigation. That *status quo* is a good place to start the analysis, with deviations requiring affirmative justification.

Of course, defendants have countervailing interests, such as being able to pursue avenues reasonably calculated to lead to material information that may help expeditiously and fairly resolve the dispute and a right to know, and confront, the real party in interest in the case they are defending.

Finally, funders' interests should also weigh in the balance. These include intellectual property in the financial products they produce and a desire to keep the costs of doing business (assuming a for-profit funder) low.[205] The latter means a legitimate concern in avoiding being dragged into the discovery process, being joined as a party, or otherwise being the target of strategic satellite litigation.

c. Forum Interests

In addition to avoiding conflicts of interest on the part of the judges, which is a basic tenet of the rule of law, core concerns for the courts and the judicial system as a whole are the efficient resolution of disputes and the overall integrity of the system. These, too, may point towards limiting satellite litigation relating to litigation funding in the form of seeking discovery from funders or joining them as codefendants for purely tactical reasons, practices which may unnecessarily complicate and raise the cost of litigation. But it also includes empowering judges

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[204] *See* Sara Randazzo, *Litigation Financing Attracts New Set of Investors*, WALL ST. J. (May 15, 2016, 5:37 PM), https://www.wsj.com/articles/litigation-financing-attracts-new-set-of-investors-1463348262 ("Pension funds, university endowments, family offices and others have collectively pumped more than a billion dollars into the sector . . . .").

[205] By analogy, contingency fee agreements receive, under certain conditions, protection based on the same rational. *See* Maya Steinitz & Abigail C. Field, *A Model Litigation Finance Contract*, 99 IOWA L. REV. 711, 722-23 (2014).

to figure out, through disclosure, whether the funding terms inappropriately incentivize lengthening the litigation timeline as well as whether the funding arrangement, e.g. the composition of a portfolio, incentivize the filing of prima facie non-meritorious claims.[206] In the same vein, the judicial system also has an interest in preventing arrangement types—such as highly synthetic derivatives backed by contingent (or even speculative) litigation proceeds—that are likely to flood the courts with non-meritorious cases.[207]

2. Factors

Each of the interests discussed above can be mapped onto one or more concrete factors in any given litigation or arbitration. This is important, because judges and arbitrators should not be left to consider in the abstract whether disclosure, as a general concept, increases access to justice or diversity in legal issues, for example, but should instead be provided with guidance for how those interests might play out in specific litigation scenarios depending on their profile, as understood in light of the variables described above. The following Subsections describe those specific factors.

a. The Profile of the Plaintiffs and Their Motive for Seeking Funding

A plaintiff's profile and reasons for seeking funding are important because they bear on the extent to which interests such as access to justice are at stake. Funded plaintiffs may be consumers, start-up companies, established corporations, developing and developed nations, a lead plaintiff in a class action, or the class

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[206] Some market participants have suggested to me that some law firms and/or corporations are asking financiers to accept weak cases as part of a portfolio if they wish to obtain the right to finance the entire portfolio (or, in other words, if they wish to do the functional equivalent of taking an equity stake in the firm). If true, this is similar to the practice of bundling prime and subprime mortgages in mortgage-based securities. To highly simplify, the idea is that by first bundling and then "slicing" the bundles, securitization allowed for the shifting of risk of subprime mortgages from the originators and primary investors to the overall secondary market and the economy as a whole. Famously, the true costs of this practice were also externalized on the subprime borrowers who ended up in foreclosure, the taxpayers who needed to bail out banks and other entities, and the global economy as a whole. *See, e.g.*, Yuliya S. Demyanyk & Otto Van Hemert, *Understanding the Subprime Mortgage Crisis*, 24 REV. FIN. STUD. 1848, 1875-76 (2011); Steve Denning, *Lest We Forget: Why We Had a Financial Crisis*, FORBES (Nov. 22, 2011, 11:28 AM), https://www.forbes.com/sites/stevedenning/2011/11/22/5086/#36da42daf92f.

[207] Steinitz, *Whose Claim Is This Anyway?*, *supra* note 147, at 1318-22.

itself, to name but some examples. The degree to which disclosure-based court involvement and the rigors of the adversarial system should be brought to bear may differ based on such characteristics of the funded plaintiffs.

To further elaborate, an established corporation might seek litigation funding as a form of corporate finance. In this scenario, one might imagine a sophisticated corporation using third-party litigation funding as a way to shift litigation risk, to manage its balance sheet, or to obtain operating capital during a time when litigation otherwise limits access to capital. Conversely, parties who might otherwise lack the resources to withstand long and expensive trials, or even to bring their claims at all, may seek financing in order to be able to access the civil justice system.[208] These cases should not be treated alike for regulatory purposes. Further, consumers are generally understood to require a higher level of protection than do sophisticated entities. Similarly, members of a class are understood to need more court protection than, perhaps, both of the preceding categories.[209]

b. Funder's Profile and Motivation

Dispassionate for-profit litigation finance firms, secretive hedge funds, wealthy individuals, family members, non-profits, law firms providing pro bono services,

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[208] *See* Anthony J. Sebok, *Private Dollars for Public Litigation: An Introduction*, 12 N.Y.U. J.L. & BUS. 813, 813-14 (2016); Anthony J. Sebok, *Should the Law Preserve Party Control? Litigation Investment, Insurance Law, and Double Standards*, 56 WM. & MARY L. REV. 833, 894-95 (2015); Steinitz & Field, *supra* note 205, at 716; W. Bradley Wendel, *Paying the Piper but Not Calling the Tune: Litigation Financing and Professional Independence*, 52 AKRON L. REV. 1, 13-14 (2018); Christopher P. Bogart, *The Case for Litigation Funding*, BURFORD: BLOG (Oct. 11, 2016), http://www.burfordcapital.com/blog/case-litigation-funding [https://perma.cc/KLZ8-99VD]; Maya Steinitz, *Contracting for Funding in "Access to Justice Cases" Versus "Corporate Finance Cases,"* MODEL LITIG. FIN. CONT. (June 24, 2013), http://litigationfinancecontract.com/contracting-for-funding-in-access-to-justice-cases-versus-corporate-finance-cases [https://perma.cc/WFK4-PD6G].

[209] This was generally held to be the case, for example, in the September 11th litigation. *See* Transcript of March 19, 2010 Status Conf., *In re* World Trade Ctr. Disaster Site Litig., 21 MC 100, Doc. No. 2037 at 54-55 (S.D.N.Y. Mar. 19, 2010). On the potential conflicts of interest that third party funding of class action may introduce, see Brian T. Fitzpatrick, *Can and Should the New Third-Party Litigation Financing Come to Class Actions?*, 19 THEORETICAL INQUIRIES L. 109, 115-23 (2018). *See generally* Deborah R. Hensler, *Third-Party Financing of Class Action Litigation in the United States: Will the Sky Fall?*, 63 DEPAUL L. REV. 499, 509-16 (2014) (outlining issues that may arise if third-party litigation financing becomes frequent in class action suits in the United States).

political action committees (PACs), foreign governments (through sovereign wealth funds or otherwise), "crowds" funding via crowdfunding platform—all these are examples of litigation funders currently active in the market. These descriptors already hint at the wide variety of possible motivations for funding: profit, affecting rule-change for ideological or commercial reasons, assisting the indigent or a family member, hindering the competition, furthering foreign policy, opening up the courts to underrepresented claims or claimants, privately enforcing the law[210]—these and more may all be motivations for funding. Some motivations are, arguably, more worthy of protection than others. To take an extreme example, consider the firestorm that followed the Gawker case, where Hogan's backer seemed to be interested, troublingly, chiefly in revenge and where his target was a member of the Fourth Estate.

To make explicit what the foregoing illustration highlights—the type-of-funder factor overlaps (but is not coextensive with) the funders' motivation. The commercial funder envisioned in the previous paragraph will likely be somewhat constrained by reputational considerations—wanting to be known for screening and backing good cases and providing decent funding terms. It is also likely to be interested in profitable cases which, usually, will correlate with meritorious ones, and will likely be uninterested in vendettas, politics, foreign relations, and the like. For good and bad, it will also not be concerned with promoting the public interest. Conversely, not-for-profit funders may be concerned with (their version of) the public interest but, of course, what constitutes and furthers the "public's interest" is often a contested matter. A sovereign wealth fund or a foreign government may seek to advance foreign policy or military goals. A one-shot funder[211] may be interested in profit, hindering a competitor, revenge, fame, or politics. A PAC, or a politically-motivated wealthy individual, will probably wish to advance a political agenda. A "crowd" may be comprised of people motivated

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[210] On third party funding's effect on private enforcement of law through class and mass action, see generally John C. Coffee, Jr., *Securities Litigation Goes Global*, LAW (Sept. 15, 2016, 12:00 AM), https://www.law.com/newyorklawjournal/almID/1202767289255/securities-litigation-goes-global/; Deborah R. Hensler, *The Future of Mass Litigation: Global Class Actions and Third- Party Litigation Funding*, 79 GEO. WASH. L. REV. 306, 322-23 (2011).

[211] On the disparate use of litigation by "one-shotters" versus "repeat players" to advance goals beyond a win in a particular case, especially to affect changes in the law, see Marc Galanter, *Why the "Haves" Come Out Ahead: Speculations on the Limits of Legal Change*, 9 LAW & SOC'Y REV. 95, 97-114 (1974) [hereinafter *Why the "Haves" Come Out Ahead*].

by justice, politics, or profit. Interestingly, as the reaction to the Gawker case illustrates, maintenance—funding without a profit motivation—may be more problematic than champerty—funding for a profit—even though much of the contemporary consternation around the rise of litigation finance focuses on "profiteering" from others' claims and from the justice system.[212]

We should leave it to the discretion of the judge whether suspicion or evidence of certain motivations should factor into the decision of whether and how much to disclose of the funding arrangement. Similarly, the weight to be given to the type of funder, which *inter alia* hints at motivation, is also a factor to weigh in the balance.

c. The Case Type and the Forum

Individual litigation, class actions, mass actions, or arbitration (which can be domestic, international regarding commercial law, or international regarding investment law) implicate completely different issues which may call for court supervision and public interest-based transparency as to how a case is funded, by whom, in what manner, and for what goal.

For example, class and mass cases, wherein the lawyers rather than the clients drive and control the case, are very different from individual claims. In the class action context, in particular, members of the class are unnamed and may even be unknown.[213] Traditionally, courts exercise more supervision over such litigation including, critically, over settlements because of the myriad conflicts they entail and the scale of threat they present to defendants. The presence of third-party funding, in lieu of or in combination with attorney funding, is likely to exacerbate

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[212] Champerty is defined as an "agreement to divide litigation proceeds between the owner of the litigated claim and a party unrelated to the lawsuit who supports or helps enforce the claim" or, more pejoratively, as "[a]n agreement between an officious intermeddler in a lawsuit and a litigant by which the intermeddler helps pursue the litigant's claim as consideration for receiving part of any judgment proceeds." *Champerty*, BLACK'S LAW DICTIONARY (11th ed. 2019). It is a form of maintenance whereby "assistance in prosecuting or defending a lawsuit [is] given to a litigant by someone who has no bona fide interest in the case." *Id.* at *Maintenance*.

[213] The writings on the conflicts of interest inherent in class and mass actions where the lawyers, rather than the clients, control the litigation are legion. *See, e.g.*, John C. Coffee, Jr., *Class Wars: The Dilemma of the Mass Tort Class Action*, 95 COLUM. L. REV. 1343, 1358-67 (1995); Samuel Issacharoff, *Class Action Conflicts*, 30 UC DAVIS L. REV. 805, 827-30 (1997); Geoffrey P. Miller, *Conflicts of Interest in Class Action Litigation: An Inquiry into the Appropriate Standard*, 2003 U. CHI. LEGAL F. 581, 597 (2003).

conflicts of interest in this context and so court involvement should be heightened as compared to individual cases.[214]

In another example, arbitration (excluding public international law disputes) is a private process conducted in a private forum. By its very essence, private adjudication behind closed doors involves less transparency than litigation in open courts. Further, arbitrators—privately appointed *ad hoc* to resolve a specific dispute based on the parties' agreement that they do so—are not a branch of the government entrusted with and required to safeguard the public interest in the same manner judges are. Arbitrators, therefore, may need to be more circumspect with the goals they wish to further in imposing disclosure.[215] But even here, more granularity and nuance are required than simply identifying the case type or the forum. For example, it is understood that international investment arbitration, in which a foreign investor sues a government for violation of a bilateral investment treaty, is a form of private adjudication of public disputes and as such arbitrators sitting in such matters must hew more closely towards both transparency and safeguarding public interests (generally[216] as well as specifically when it comes to disclosure of who is funding the arbitration, in what manner, and in furtherance of what goals[217]).

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[214] A commendable example is a recent procedural order by Judge Polster of the United States District Court for the Northern District of Ohio, discussed *infra* Section D of this Part.

[215] For the debates on the proper disclosure regime in international commercial arbitration, see Elizabeth Chan, *Proposed Guidelines for the Disclosure of Third-Party Funding Arrangements in International Arbitration*, 26 AM. REV. INT'L ARB. 281, 281-83 (2015); Jennifer A. Trusz, Note, *Full Disclosure? Conflicts of Interest Arising from Third-Party Funding in International Commercial Arbitration*, 101 GEO. L.J. 1649, 1673 (2013).

[216] For discussions of international investment arbitration as a form of public law and the attendant considerations arbitrators must consider, see generally Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions*, 73 FORDHAM L. REV. 1521, 1543-45 (2005); Stephan W. Schill, *Enhancing International Investment Law's Legitimacy: Conceptual and Methodological Foundations of a New Public Law Approach*, 52 VA. J. INT'L L. 57, 71-73 (2011).

[217] For discussion of the proper disclosure regime in international investment arbitration, and how it differs from the desirable regime in international commercial arbitration, see Rachel Denae Thrasher, *Expansive Disclosure: Regulating Third-Party Funding for Future Analysis and Reform*, 59 B.C. L. REV. 2935, 2944-48 (2018); Frank J. Garcia, *The Case Against Third-Party Funding in Investment Arbitration*, INT'L INST. SUSTAINABLE DEV. (July 30, 2018), https://www.iisd.org/itn/2018/07/30/the-case-against-third-party-funding-in-investment-arbitration-frank-garcia [https://perma.cc/52YH-4EZU].

d. The Subject Matter

Funders have shown interest in cases spanning areas such as contracts, torts, antitrust, intellectual property, consumer protection, *qui tam*, individual and mass torts, human and civil rights, divorce, international commercial, and investment law—to name some common examples. The degree of disclosure desirable in these disparate areas of law is, arguably, different.

One can easily argue, for example, that transparency with respect to those pulling the purse strings and influencing legal argumentation, strategy, settlement, and precedent-making is much more important in international investment disputes, which are governed by public international law, involve the distribution of public money into private hands, and often adjudicate the validity of the conformity of regulation and legislation in the areas of environmental protection, workers' rights, and consumer protection with sovereigns' international obligation than it is in international commercial arbitration involving contracts between private parties.[218]

Similarly, divorce often implicates the third-party interests of minors. Therefore, who influences the course of such litigation and its outcome, and the court's ability to bring such potentially real party in interest forth is different than in, say, contract or even tort disputes.[219]

As these examples illustrate, the subject matter of the litigation should affect whether and what form disclosure of funding is appropriate.

e. Potential Effect on the Development of the Law

Famously, and as alluded to above, repeat players—like corporations, insurance companies, and third-party funders—can and do "play for rules," namely litigate rather than settle in order to change the content of the law.[220] And "[w]hile rule

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[218] International investment law involves the protection of foreign investors from governments in the jurisdictions in which they invest. Rights of action are afforded only to the former, not the latter, and are granted in Bilateral Investment Treaties (hence, the public international law nature of the dispute). *See* KATE MILES, THE ORIGINS OF INTERNATIONAL INVESTMENT LAW: EMPIRE, ENVIRONMENT AND THE SAFEGUARDING OF CAPITAL 88-90 (2013).

[219] On divorce finance, see Jeff Landers, *Can't Afford Your Divorce? New Firms Specialize in Divorce Funding*, FORBES (Jan. 15, 2015, 3:24 PM), https://www.forbes.com/sites/jefflanders/2015/01/15/cant-afford-your-divorce-new-firms-specialize-in-divorce-funding/#29b3d2457715.

[220] *See* Galanter, *Why the "Haves" Come Out Ahead*, *supra* note 211, at 100.

change is a public good, it may be profitable for litigation funders to invest in rule change. This is because they manage a portfolio of litigation and, in particular, because they invest repeatedly and sequentially in certain categories of cases."[221] Investing in precedent, in other words, is as valuable for repeat players as is lobbying for legislative change:

> [G]oing to trial specifically in order to obtain rule change may be strategic for litigation funders . . . because the value of precedent is greater for them than it is for their one-shotter clients. Economists have argued that "when neither party is interested in precedent, there is no incentive to litigate, and hence no pressure on the law to change. When only one party is interested in precedent, that party will litigate until a favorable decision is obtained; the law in such cases will favor parties with such an *ongoing interest*."[222]

Not every case has the potential to set precedent and change the course of the law. But when a judge believes the case before her is of such nature, it is reasonable to suggest she takes that factor under consideration, when deciding whether, to what extent, and to whom disclosure is warranted. Under such circumstances probing, for example, who controls the litigation—whether it is the client or the funder—takes on a heightened significance.

f. The Structure of the Financing

The way financing is structured is, perhaps surprisingly, also an important factor to consider when deciding what degree of involvement by the decisionmaker is warranted.[223] For example, a case may be invested in passively or actively.

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[221] Steinitz, *Whose Claim Is This Anyway?*, *supra* note 147, at 1312.

[222] *Id.* at 1315 (quoting Paul H. Rubin, *Why Is the Common Law Efficient?*, 6 J. LEGAL STUD. 51, 61 (1977)) (internal quotation marks added); *see also* Paul H. Rubin & Martin J. Bailey, *The Role of Lawyers in Changing the Law*, 23 J. LEGAL STUD. 807, 807 (1994).

[223] This often-overlooked factor is, in fact, so important that its nuances and intricacies is a main reason that the ICCA–Queen Mary Task Force's soft law production effort ended up punting, rather than reaching, an agreed-upon guideline on disclosure. For a critique of the Task Force's grasp of the effects of deal structures, see Christopher P. Bogart, *Deeply Flawed: A Perspective on the ICCA-Queen Mary Task Force on Third-Party Funding*, BURFORD: BLOG (Oct. 6, 2017), http://www.burfordcapital.com/blog/icca-queen-mary-task-force-report-flaws [https://perma.cc/9NJK-XCLU]. For scholarship on different possible litigation finance structures, see generally Radek Goral, *The Law of Interest Versus the Interest of Law, or on Lending to Law Firms*, 29 GEO. J. LEGAL ETHICS 253 (2016); Anthony J.

Namely, a funder may never get involved after initially vetting a case, requiring only to be informed of material developments. On the other end of the spectrum, a funder may be very involved, including in selecting the lawyers, dictating strategy, and controlling settlement decisions.[224] Historically, the greater the control by the funder, the greater the suspicion and protection exercised by courts (through the intricacies of the doctrine of champerty).[225]

By the same token, the funding of individual cases involves different considerations than does the rapidly-growing funding of portfolios of cases. In the latter investment structure, the funders often contract directly with the law firm and plaintiffs may not even be aware that their cases are being funded.[226] They may therefore not be aware of salient features of their case such as the resulting

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Sebok & W. Bradley Wendel, *Duty in the Litigation-Investment Agreement: The Choice Between Tort and Contract Norms When the Deal Breaks Down*, 66 VAND. L. REV. 1831 (2013); Maya Steinitz, *Incorporating Legal Claims*, 90 NOTRE DAME L. REV. 1155 (2015); Steinitz & Field, *supra* note 205.

[224] In the Mize litigation, for example, the funder bargained for an explicit right to control settlement including a purported right to require the plaintiff to continue litigation and prohibit her from settling or withdrawing. *See* Mize v. Kai, Inc., No. 17-cv-00915-NYW, 2018 WL 1035084, at *5 (D. Colo. Feb. 23, 2018) ("The agreement purports to limit Ms. Mize's ability to 'discontinue the Claims with[out] the prior consent of [Litigation Management]' . . . and prohibits Ms. Mize from settling the case without prior consent of Litigation Management and requires Ms. Mize to settle if so directed by Litigation Management.").

[225] *See* Stan Lee Media, Inc. v. Walt Disney Co., No. 12-cv-02663-WJM-KMT, 2015 WL 5210655, at *2-3 (D. Colo. Sept. 8, 2015) (stating that due to an entity's funding and control of litigation there is "a colorable argument that [the entity] should be held to be a party to the underlying litigation"); Abu-Ghazaleh v. Chaul, 36 So. 3d 691, 693-94 (Fla. Dist. Ct. App. 2009) (finding that a funder could be a party to a suit despite not being named in pleadings if they had sufficient control). The same rationale applies to court scrutiny of the selection of class counsel, litigation conduct, and settlement in class action. *See generally* BRIAN ANDERSON & ANDREW TRASK, THE CLASS ACTION PLAYBOOK (2d ed. 2012) (referencing the ways in which attorneys, not clients, control class actions and the consequent safeguards placed by the rules of procedure and the court to protect the class member-clients).

[226] *See* ROSS WALLIN, CURIAM, PORTFOLIO FINANCE AS A TOOL FOR LAW FIRM BUSINESS DEVELOPMENT (2018), https://www.curiam.com/wp-content/uploads/Ross-Wallin-Westlaw-Journal-Article.pdf [https://perma.cc/4QPR-WY6L] ("In portfolio finance transactions, a litigation finance company provides capital to a firm . . . in exchange for a negotiated share in whatever proceeds the firm receives from a portfolio of cases."). The September 11th case is an example of a case in which the plaintiffs had no idea of the funding until they were slapped with the fees for it. *See* Binyamin Appelbaum, *Investors Put Money on Lawsuits to Get Payouts*, N.Y. TIMES (Nov. 14, 2010), https://www.nytimes.com/2010/11/15/business/15lawsuit.html.

conflicts of interest and how the interest formula may affect their lawyers' recommendations on whether, when, and for how much to settle.[227]

And here is yet another example from this more-obscure and less self-evident factor: whether a funder is reserving the right to create derivatives tied to the litigation proceeds may have systemic effects on the courts and may therefore implicate a public interest that is otherwise not common with respect to how one finances her case.[228] To understand whether such a securitization prospect exists, decision-makers may need to see whether certain terms—such as a right to assign the claim or a portfolio of claims—are included in the funding agreement, especially if the agreement is a standard form developed by funders.

More broadly, certain structuring may render a litigation contract a security. In such a scenario, a whole host of securities regulation may come to bear.[229] And there may be additional crossover regulation implicated in other funding

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[227] *See* N.Y. City Bar, Comm. on Prof'l Ethics, Opinion 2018-5 (July 30, 2018), https://www.nycbar.org/member-and-career-services/committees/reports-listing/reports/detail/formal-opinion-2018-5-litigation-funders-contingent-interest-in-legal-fees (reasoning that portfolio funding may conflict with attorneys' independence and independent judgment).

[228] *See* Steinitz, *Whose Claim Is This Anyway?*, *supra* note 147, at 1282-83 (discussing the potential systemic effects of litigation proceed-backed securities) ("[I]t is possible that in the foreseeable future we will also be witnessing the creation of a new form of securities — legal-claims-backed securities. Reportedly, some tort-litigation lenders are already in the practice of aggregating the claims they acquire and selling shares of the composite funds; that is, they are engaged in a rudimentary form of securitization. Further support of the proposition that securitization of this new asset class, namely legal claims and defenses, may be forthcoming in the near future can be gleaned from the fact that the first wave of litigation funding also generated a smattering of similar secondary trading in legal claims. A few lawsuits were syndicated during the 1980s, with some instances of syndication ending up in litigation. In addition, there is one case in which shares in future judgments have been traded on Nasdaq." (citations omitted)). For sources on the logic of bundling prime and subprime investments — be they mortgages or lawsuits — via securitization and the potential negative externalities such practices, if unchecked, can cause, including negative systemic effects, see *supra* note 206 and accompanying text.

[229] *See generally* Wendy Gerwick Couture, *Securities Regulation of Alternative Litigation Finance*, 42 SEC. REG. L.J. 5, 16-19 (2014); Wendy Couture, *Does Litigation Finance Implicate the Policies Underlying the Securities Laws?*, MODEL LITIG. FIN. CONT. (Oct. 7, 2013), http://litigationfinancecontract.com/does-litigation-finance-implicate-the-policies-underlying-the-securities-laws/ [https://perma.cc/K34H-VWH6] ("[L]itigation finance implicates the securities laws' policy of ensuring disclosure. Therefore, to the extent that a litigation finance contract satisfies the elements of an 'investment contract,' it should be subject to securities regulation."); Richard Painter, *The Model Contract and the Securities Laws Part III*, MODEL LITIG. FIN. CONT. (July 22, 2013), http://litigationfinancecontract.com/the-model-contract-and-the-securities-laws-part-iii [https://perma.cc/MZ8S-YB77].

scenarios such as when a litigation is crowdfunded since crowdfunding is subject to its own set of regulation.[230] The foregoing highlights the fact that various regulators (not only courts) may have an interest in the terms under which litigation is funded, the structure funding takes, and the systemic effects those might have on the civil justice system as a whole as well as on the investing public.

g. The Purpose of the Contemplated Disclosure

The purpose(s) for which disclosure is sought—which may evolve and change over the course of the litigation—can and should also affect not only whether disclosure is warranted and to whom but especially which part of a funding agreement should be disclosed.

If the purpose of disclosure is for a judge or arbitrator to check for conflicts, disclosing the identity of the funder (and possibly its parent entities) may suffice and could potentially be done *in camera*. If the purpose is to determine whether the funder is a real party in interest,[231] which the court might wish to subject to its authority or a party that should be granted a right to intervene, then the level of control obtained by the funder—which may be embedded in a host of provisions in the funding agreement[232]—may be relevant. In another example, if a party (e.g., a member of a class) or the court suspect a funder is engaged in the unauthorized practice of law, disclosure of the role afforded to the funder in the funding agreement will legitimately be in question, and may possibly come up through a so-called intervention.[233] When supervision of a settlement is in question, both

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[230] On the advent of crowdfunding, see generally Manuel A. Gomez, *Crowdfunded Justice: On the Potential Benefits and Challenges of Crowdfunding as a Litigation Financing Tool*, 49 U.S.F. L. REV. 307, 321-333 (2015); Ronen Perry, *Crowdfunding Civil Justice*, 59 B.C. L. REV. 1357, 1361-73 (2018). For regulation of crowdfunding generally, see, for example, 17 C.F.R. § 227.201 (2017) (outlining disclosure requirements).

[231] *See* FED. R. CIV. P. 17(a) ("An action must be prosecuted in the name of the real party in interest."). In *Abu-Ghazaleh v. Chaul*, 36 So. 3d 691 (Fla. Dist. Ct. App. 2009), a funder "was to receive 18.33% of any award" and "had to approve the filing of the lawsuit; controlled the selection of the plaintiffs' attorneys; recruited fact and expert witnesses; received, reviewed and approved counsel's bills; and had the ability to veto any settlement agreements." *Id.* at 693. Under those circumstances, the Court of Appeal of Florida held that the funder has achieved the status of "party" under Florida law irrespective of the fact that it was not so named in the pleadings. *Id.* at 693-94.

[232] The direct and, more interestingly, indirect ways funders can gain control over the litigation are discussed in Steinitz & Field, *supra* note 205, at 735-40.

[233] *See* 7B CHARLES ALAN WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE AND PROCEDURE § 1799 (3d ed. 2019) (explaining that intervention "enable[s] class members on the outside of

the degree of control and the funding formula may be fair game for scrutiny by a judge or members of a class.[234] Financial terms may also be relevant to determination of late-stage issues such as whether and how much fees to shift at the end of a case.[235]

The public interest in transparency with respect to understanding the scope and nature of the new, growing, and game-changing phenomenon of litigation finance could be another goal of disclosure.[236]

The purpose of requesting disclosure may be of an altogether different nature, though: abusive disclosure. Namely, requests for disclosure aimed at dragging a funder into discovery disputes or even into the main litigation as a party in order to prolong the litigation and raise its costs; to seek to find out the plaintiff's "reservation point"[237] at which it will settle not on the merits but because funding has been exhausted or for some other, non-merits-based reason; and to glean the

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the litigation to function as effective watchdogs to make certain that the action is fully and fairly conducted").

[234] Judge Hellerstein's decision in the September 11th case, discussed *supra* note 226, in which he held, when scrutinizing a settlement, that attorneys, rather than the plaintiffs, should absorb the costs of interest paid on loans used to finance the litigation, is an example of why and when the financial terms may need to be disclosed. For a further discussion of the fee controversy surrounding the case, see Mireya Navarro, *Already Under Fire, Lawyers for 9/11 Workers Are Ordered to Justify Some Fees*, N.Y. TIMES (Aug. 27, 2010), https://www.nytimes.com/2010/08/27/nyregion/27lawsuit.html.

[235] In international arbitration scholarship much ink has been shed, and some arbitral decisions have been issued, on the question of whether disclosure of funding is necessary in order for arbitrators to determine whether to shift fees (a norm in international arbitration which follows the so-called "British Rule" (loser pays) with respect to fee shifts). *See, e.g.*, Trusz, *supra* note 215, at 1677 (arguing that "institutions should expressly provide that the tribunal may not consider third-party funding in any decisions on costs or security for costs"). That scholarship and jurisprudence also discusses whether and to what extent disclosure is warranted at the beginning of the process in order to determine whether security of costs is warranted. *See, e.g.*, Chan, *supra* note 215, at 283 (arguing that an arbitral tribunal should be able to consider the funder's financial support and the terms of withdrawal for the funder when considering security for costs); Kelsie Massini, *Risk Versus Reward: The Increasing Use of Third Funders in International Arbitration and the Awarding Security for Costs*, 7 Y.B. ARB. & MEDIATION 323, 330-32 (2015) (arguing that it is beneficial for the funder to be disclosed at the start of the arbitration proceedings for security of costs purposes).

[236] *See supra* text accompanying notes 197–203.

[237] A "reservation point" is "the least favorable settlement that the client is willing to accept." LARRY L. TEPLY, LEGAL NEGOTIATION IN A NUTSHELL 81 (3d ed. 2016) (emphasis omitted). The reservation point is affected by factors other than the value of the negotiated asset and knowing an opposing party's reservation point enables a party to make the lowest offer that would be accepted.

type of proprietary financial products a funder has developed for competitive reasons that have nothing to do with the case at hand.

h. The Procedural Posture of the Case

The purpose for which disclosure is sought, as the discussion in the preceding Subsection implicates, bleeds into another factor: the procedural posture of a case. Funders have been known to step in and invest in a case before it is filed, after filing but before trial, after trial but before appeal, and after a final judgment or award has been rendered at the enforcement or collection stage.[238] The procedural posture can and should affect disclosure decisions.

For example, at the enforcement or collection stage, financial or control terms, which may have been relevant earlier in the proceedings, may no longer be relevant; still, the nature of the case and of the parties may continue to be relevant. And in another hypothetical, the very fact of funding, but nothing more, may be all that is needed when deciding whether a contender for the role of class counsel is "adequate" as required by FRCP Rule 23.[239]

B. An Iterative Inquiry

Further, I suggest that the proposed balancing test may be deployed, with appropriate modifications for timing and context and with due regard to cost, at any stage of the litigation or arbitration. The analysis could even be repeated at different stages of the litigation because, as the preceding Subsection explains, the applicable factors may be different leading to a different result as to whether, to what extent, and in what form to order any disclosure.

For instance, at the commencement of an international arbitration, the fact of funding and identity of the funder may be sufficient because the question at hand for a tribunal to decide is whether conflicts of interests exits. But at the end of the process, if the case has not settled, the tribunal may need to see the financial and control terms in order to decide whether and how much of the fees to shift under

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[238] *See, e.g.*, *Commercial Litigation Funding*, BENTHAM IMF, https://www.benthamimf.com/what-we-do/commercial-funding (last visited Sept. 9, 2019) [https://perma.cc/2KFN-6NAQ] (stating that Bentham invests in claims at the pre-trial and trial steps, as well as during appeals and to help with judgment collections).

[239] *See* FED. R. CIV. P. 23(g)(1)(A)(iv). For the jurisprudential elaborations of these requirements, see JEROLD S. SOLOVY ET AL., 5 MOORE'S FEDERAL PRACTICE § 23.120 (2003).

the "loser pay" convention.[240] Financial provisions—e.g., how much funding has been committed and what formula is used to the divide the litigation proceeds—are regarded as particularly sensitive by many plaintiffs and funders and particularly open to strategic gaming by defendants who can "game" the litigation aiming to spend down the committed amount or trigger acceleration of interest.

The option to reevaluate can help prevent over-disclosure early on which may prove unnecessary if a case settles early.

C. Additional Disclosure Calibration Tools

At this point, it should be evident that disclosure is a process, not an event, and that decision-makers are faced with a spectrum of options, not with a "zero sum" decision.

At one end of the spectrum, a judge or an arbitrator may require disclosure *in camera* of the existence of funding only, with or without the mere identity of the funder included. At the other end of the spectrum, is the disclosure to the court, opposing party, and filing for the public record of the entire agreement. In the middle of the spectrum are such tools as the disclosure of certain provisions only and the redaction of others or the filing of a short, check-the-box closing statement. A decision-maker can create further gradations by either declining a disclosure without prejudice so that the matter can be revisited as the litigation progresses or, conversely, by imposing a continuing duty to disclose so that if the existence of funding or the identity of funders change throughout the life of the litigation a plaintiff is under an obligation to so disclose.

In addition to regarding the disclosure decision as one that can be revisiting later in the process, as suggested above, decisionmakers can make use of *in camera* and/or *ex parte* submissions, redactions, "attorney's eyes only" designations, filing all or parts of the funding agreement under seal, or requesting attorneys to certify representations about what an undisclosed agreement does or does not contain. In short, the basic tools generally available to moderate undesirable effects of discovery are all available in this context as well.

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[240] *See* INT'L COUNCIL FOR COMMERCIAL ARBITRATION, *supra* note 148, at 159.

The final, concluding Section of this Part provides an example of well-calibrated, context-sensitive disclosure by a federal judge presiding over a multidistrict litigation ("MDL").

D. An Example: The Order Regarding Third-Party Contingent Litigation Financing in In re Nat'l Prescription Opiate Litigation

A commendable example of a nuanced judicial approach that appears to have taken into account the type of case, the funded parties, the procedural posture, the possible deal structure (and its effects on conflicts of interest) and that made use of tools such *ex parte* submissions and certification by the attorneys, is an order by Judge Polster of the United States District Court for the Northern District of Ohio, presiding over an MDL.

Preliminarily, it should be noted that Judge Polster both broadly defined "third-party contingent litigation financing" as "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 an MDL Case, by settlement, judgment, or otherwise,"[241] and surgically exacted that the term does not include "subrogation interests, such as the rights of medical insurers to recover from a successful personal-injury plaintiff."[242]

Next is the disclosure regime tailored by Judge Polster to the case at bar. "Absent extraordinary circumstances," he ordered, "the Court will not allow discovery into [third-party contingent litigation] financing,"[243] but "any attorney in any MDL Case that has obtained [third-party contingent litigation] financing shall:

- share a copy of this Order with any lender or potential lender.
- submit to the Court *ex parte*, for in camera review, the following:

  (A) a letter identifying and briefly describing the [third-party contingent litigation] financing; and

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[241] Order Regarding Third-Party Contingent Litigation Financing, *In re* Nat'l Prescription Opiate Litig., No. 1:17-MD-2804, 2018 WL 2127807, at *1 (N.D. Ohio May 7, 2018).

[242] *Id.* at 1 n.1.

[243] *Id.* at 1.

> (B) two sworn affirmations—one from counsel and one from the lender—that the [third-party contingent litigation] financing does not:
>
> > (1) create any conflict of interest for counsel,
> >
> > (2) undermine counsel's obligation of vigorous advocacy,
> >
> > (3) affect counsel's independent professional judgment,
> >
> > (4) give to the lender any control over litigation strategy or settlement decisions, or
> >
> > (5) affect party control of settlement."[244]

In so ordering, without handing defendants an informational windfall, the court thus placed the burden of safeguarding legal ethics despite the complications of third-party funding, and potential liability in case of a failure to meet it, on the gatekeepers with the best view of whether problems exist or arise. And it also placed the lawyers, existing and potential funders on notice that the watchful eye of the court is upon them.

CONCLUSION

In sum, the quest for a disclosure rule has set policymakers on a wild goose chase that has led some to avoid or punt on the issue all together while leading others to propose disclosure regimes that are either over- or under-protective of the multiple stakeholders in this regulatory quandary—namely, plaintiffs, defendants, funders, the public, and the courts—and their varying complex and shifting interests. By reminding the legal community of the availability of standards, especially balancing tests, and by fleshing out the specifics of what such a balancing test might consist of in this context, I have endeavored to break the Gordian knot of the surprisingly difficult question of whether and how to structure a disclosure regime for litigation finance.

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[244] *Id.*

What's So New About Litigation Finance?

Disclosure and Regulation of a New Take on an Old Practice

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Discussions of litigation finance frequently begin with the implicit or explicit assumption that litigation finance is something *new* — a decidedly modern and 21st-century method of financing litigation. This is particularly true for the debate about whether a mandatory disclosure rule should compel the automatic disclosure of litigation finance agreements at the outset of litigation. Many arguments in favor of mandatory disclosure of litigation investment agreements stress litigation finance's ostensible novelty, contending that mandatory disclosure is necessary to combat litigation funding's fresh and unique threat to a lawyer's ethical duties, to the champerty and maintenance laws, or to some other legal or ethical prohibition.[245]

This essay challenges the assumption that litigation finance or the risks it allegedly presents are particularly new or unique, and it demonstrates why undermining this faulty assumption goes a long way toward defeating many of the arguments in favor of mandatory disclosure of litigation finance agreements.

In one sense, of course, it is plainly true that modern litigation finance is new. The birth of contemporary "litigation finance" companies dates only to the 1990s in Australia and the United Kingdom.[246] In the United States, commercial litigation finance did not take off until the 2000s, when Credit Suisse launched an appeals funding business, and later when Bentham IMF, Juridica Investments, and Burford Capital entered the U.S. market.[247] When we talk about modern litigation finance companies, we are not talking about companies with the vintage of American Express, AT&T, or even Apple.

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[245] *See*, *e.g.*, 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 at 2, 7 (June 1, 2017) ("Chamber Letter") (advocating mandatory disclosure after casting litigation finance as a novel industry that has seen "[r]apid [g]rowth" and "a dramatic expansion" since 2014); Joshua G. Richey, Comment, *Tilted Scales of Justice? The Consequences of Third-Party Financing of American Litigation*, 63 EMORY L.J. 489, 489 (2013) (describing litigation finance as a "relatively new phenomenon," in the course of arguing for increased regulation including mandatory disclosure). *See also*, *e.g.*, Letter from Charles E. Grassley, Chairman, U.S. Senate Judiciary Comm., & John Cornyn, Chairman, U.S. Senate Judiciary Comm., to Sir Peter Middleton, Chairman, Burford Capital (Aug. 27, 2015) (requesting information from practitioners about the "burgeoning industry" of litigation finance).

[246] Marco de Morpurgo, *A Comparative Legal & Economic Approach to Third-Party Litigation Funding*, 19 CARDOZO J. INT'L & COMP. L. 343, 360–61 (2011).

[247] *See*, *e.g.*, Lake Whillans, *The History and Evolution of Litigation Finance*, ABOVE THE LAW (Jan. 27, 2017), https://bit.ly/2olrxCc; Mattathias Schwartz, *Should You Be Allowed to Invest in a Lawsuit?*, N.Y. TIMES (Oct. 22, 2015), https://nyti.ms/369e4yv.

But in another sense, third-party litigation finance is not particularly new.[248] To see why, it's helpful to first define "litigation finance." At its broadest level, litigation funders provide capital to individuals or corporations in connection with legal claims.[249] Most commonly, a commercial litigation finance company helps a plaintiff-side claimholder meet the costs of litigation, including attorneys' fees and litigation expenses like expert fees, court filing costs, and travel expenses.[250] The funder pays some or all of those fees and costs, and in exchange, the funder is entitled to a portion of any case proceeds.[251] Litigation finance transactions are typically "non-recourse," which means that the funder's return is secured only by proceeds from the funded case(s).[252]

The truth is that non-parties to a case have been helping individuals and companies meet the often-exorbitant costs of litigation for decades and centuries, and they have frequently done so in exchange for a share of case proceeds. Our legal system has not simply permitted these methods of third-party financing — it has often actively encouraged them, recognizing that they are important ways to further access to the courts, particularly for those without the funds to self-finance litigation.

We don't have to search far and wide for examples. When a lawyer takes a case on contingency, litigating the case for no up-front charge in exchange for a share of case proceeds, she provides third-party financing. When an individual receives free legal services from a public interest organization, she benefits from third-party financing. When an employer pays an employee's legal fees, or when a parent pays an adult child's divorce costs, the employer and parent provide third-

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[248] For an expanded version of the argument that modern litigation finance is not particularly "new," see Suneal Bedi & William C. Marra, *The Shadows of Litigation Finance*, 74 VAND. L. REV. __ (forthcoming 2021).

[249] Maya Steinitz, *Whose Claim Is This Anyway? Third-Party Litigation Funding*, 95 MINN. L. REV. 1268, 1276 (2011) (defining "litigation finance" as "the provision of funds by companies who have no other connection with the litigation"). *See generally* Anthony Sebok, *Litigation Investment and Legal Ethics: What are the Real Issues?*, 55 CAN. BUS. L.J. 111, 112 (2014).

[250] de Morpurgo, *supra* note 2, at 350–51 (2011) (defining litigation finance as "the specific practice in which a third party offers financial support to a claimant in order to cover his litigation expenses, in return for a share of damages if the claim is successful, or nothing is the case is lost").

[251] Mariel Rodak, Comment, *It's About Time: A Systems Thinking Analysis of the Litigation Finance Industry and Its Effect on Settlement*, 155 U. PA. L. REV. 503, 507 (2006).

[252] Maya Steinitz & Abigail C. Field, *A Model Litigation Finance Contract*, 99 IOWA L. REV. 711, 713 (2014); Rodak, *supra* note 7, at 507.

party financing. These are just a few ways in which non-party funding of litigation is a bedrock feature of our civil justice system.

It turns out that third-party litigation finance is, and long has been, all around us. These modes of third-party financing are not all precisely the same as commercial litigation finance. But these are distinctions without a difference for purposes of the question whether third-party financing agreements should be the subject of mandatory disclosure rules.

This essay does not purport to review all the arguments for and against disclosure, either via mandatory disclosure or disclosure on a case-by-case basis. Instead, I focus on the debate about mandatory disclosure of funding agreements at the outset of litigation. At the federal level, the push for mandatory disclosure of funding agreements is happening both before the Federal Rules Committee and in Congress. Before the Federal Rules Committee, the United States Chamber of Commerce has requested a rule that requires the initial disclosure of "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."[253] In Congress, Senator Chuck Grassley has introduced the Litigation Funding Transparency Act in both 2018 and 2019, seeking to require the automatic disclosure, at the outset of class actions and multidistrict litigations, of both the identity of any party with a financial interest in the case (other than the named parties or counsel) and the funding agreement itself.[254]

These proposals would expand disclosure requirements in two ways. First, they would require broader disclosure of the *identity* of parties that are funding litigation than is currently required under the current rules.[255] And second, they would require the disclosure of the *funding agreement* itself.

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[253] *See* ADVISORY COMM. ON CIVIL RULES, AGENDA BOOK 345 (Nov. 2017), https://bit.ly/3j9VvzE; Maya Steinitz, *Follow the Money? A Proposed Approach for Disclosure of Litigation Finance Agreements*, 53 U.C. DAVIS L. REV. 1073, 1078 (2019).

[254] Litigation Funding Transparency Act of 2019, S. 471, 116th Cong. (2019); Litigation Funding Transparency Act of 2018, S. 2815, 115th Cong. (2018); Steinitz, *Follow the Money*, *supra* note 9, at 1077.

[255] Federal Rule of Civil Procedure 7.1 currently requires litigants to disclose at the outset of litigation the identity of "any parent corporation and any publicly held corporation owning 10% or more of its stock," to allow judges to determine whether they should disqualify from a case. FED. R. CIV. P. 7.1(a)(1). *See also id.*, Committee Notes on Rule – 2002

The arguments in support of mandatory disclosure presume that the modern litigation finance industry represents a novel introduction of third-party funders into our legal system, presenting unique risks that require a new disclosure regime. Part I of this essay debunks this premise and demonstrates that our legal system has long permitted and indeed encouraged third parties to finance litigation to which they are not a party. The modern litigation finance industry is not different in kind from these other forms of third-party funding.

Part II of this essay then demonstrates that the leading arguments in support of mandatory disclosure — that litigation finance threatens a lawyer's independence, may involve unethical fee arrangements, may give rise to judicial conflicts of interest, and may involve champertous funding agreements — could just as easily be levied against the forms of third-party financing our legal system has long allowed. But we have not subjected these other forms of third-party financing to mandatory disclosure rules that require litigants to immediately disclose their third-party financing without regard to a showing of relevance, proportionality, and the absence of privilege. For example, litigants generally need not disclose whether their lawyers are working on a contingency fee, whether a family member is paying the costs of their divorce proceeding, or whether a third party is funding their lawsuit on a pro bono basis.

The upshot: it is very difficult to justify mandatory disclosure of modern "litigation finance" agreements provided by commercial or consumer litigation finance companies, when we have not required disclosure of the various other forms of third-party financing. And by resisting unnecessary mandatory disclosure for only one form of third-party financing — by refusing to essentially impose an indirect tax upon litigation finance — we help make our civil justice system more accessible to all Americans, allowing even those without millions of dollars in the bank to press their legal rights.

(stating that the rule "will support properly informed disqualification decisions in situations that call for automatic disqualification under [the Code of Conduct for United States Judges]." Some federal courts require by local rule expanded disclosure of entities with a financial interest in the case, though these rules are frequently limited to the disclosure of interests held by publicly held corporations only, and they do not require the disclosure of any underlying financing agreements. *See* Steinitz, *Follow the Money*, *supra* note 9, at 1079–80; ADVISORY COMM. ON CIVIL RULES AGENDA BOOK 209–29 (Apr. 2018), https://bit.ly/31mdf4u

I. LITIGATION FINANCE BY ANOTHER NAME

It's helpful to start with a simple question: Why do parties seek litigation finance? Two motivations usually drive the decision: *liquidity constraints* and *risk aversion*.[256]

First, with respect to liquidity constraints: Litigation is expensive.[257] The United States ranks 99th out of 126 countries for affordability and accessibility of civil justice.[258] Bringing even a straightforward breach of contract claim can cost hundreds of thousands, or even millions, of dollars. Not everyone has that kind of money. The illiquid can be the truly indigent — those without any money to their name — but it can also include those who have enough money to pay for second-rate counsel but not their first-choice lawyers. If claimholders are forced to rely *only* on their personal resources to bring a suit, those without sufficient liquidity will be forced to abandon their claims entirely, or to proceed with counsel who are not the right fit, perhaps because they lack sufficient expertise in the case's subject matter. If claimholders are permitted to obtain financing from others — whether from their counsel through contingency fee arrangements, or from third parties like commercial litigation funders —their ability to access the courts will be significantly enhanced.[259]

Second, with respect to risk aversion: Litigation is an uncertain endeavor. Claimholders must invest money today in the hope that a court will vindicate their claims and award them relief at some uncertain time in the future.[260] Risk sharing

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[256] For an expanded discussion of how liquidity constraints and risk aversion drive the decision to obtain litigation finance, see Bedi & Marra, *supra* note 4.

[257] *See* HON. JOHN G. ROBERTS, JR., 2015 YEAR-END REPORT ON THE FEDERAL JUDICIARY (2015) at 4, 11, https://bit.ly/2q73g1n (arguing that "in many cases civil litigation has become too expensive, time-consuming, and contentious, inhibiting effective access to the courts").

[258] William C. Silverman & Madison Marko, *The Right to Counsel in Civil Proceedings: An International Perspective*, PROSKAUER ROSE LLP (Apr. 11, 2019), https://bit.ly/2Qf1ZQD

[259] W. Bradley Wendell, *Paying the Piper But Not Calling the Tune: Litigation Finance and Professional Independence*, 52 AKRON L. REV. 1, 9–10 (2018); *Lawsuit Funding, LLC v. Lessoff*, 2013 WL 6409971 (N.Y. Sup. Ct. 2013) ("[L]itigation funding allows lawsuits to be decided on their merits, and not based on which party has deeper pockets or stronger appetite for protracted litigation.").

[260] Joanna M. Shepherd & Judd E. Stone II, *Economic Conundrums in Search of a Solution: The Functions of Third-Party Litigation Finance*, 47 ARIZ. ST. L.J. 919, 927 (2015) ("Prosecuting litigation necessarily requires an immediate substantial capital investment for a remote future reward."); David M.

is an integral part of many endeavors in life, and few business owners bear the entire risk and cost of starting a company, launching a new product, or expanding into a new territory.[261] Just as companies frequently share risk for these ventures by raising equity, issuing debt, or obtaining other forms of financing, so too might they desire to offload some of the risk associated with litigating a case.[262]

As you might imagine, the twin problems of liquidity constraints and risk aversion have existed for centuries. More to the point, they long predate modern litigation finance. It should thus come as no surprise that it wasn't only ten or fifteen years ago that claimholders started to find ways to solve their liquidity or risk-tolerance problems.

In fact, we don't have to strain to find lots of ways in which third parties have long helped the indigent, the otherwise illiquid, or the risk averse bring meritorious legal claims. Sometimes, the non-party finances the claim in exchange for a stake in the outcome of the litigation, or for some other financial reason. In other instances, the non-party operates from a non-financial motive, which might include pure benevolence or the desire to shape the law in a particular way.

Here are just some ways third parties help finance a claimholder's litigation:

1. CONTINGENCY FEE LITIGATION

The contingency fee arrangement is such a bedrock part of our legal system that it is easy to overlook it as a form of third-party financing. Lawyers who work on a contingency fee do not charge their clients any fees for litigating their case. Instead, the lawyer works "for free," litigating the case but charging the client nothing up front.[263] Sometimes the lawyer even pays the (often-substantial) costs and disbursements associated with bringing a case, such as expert costs and court

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Trubek et al., *The Costs of Ordinary Litigation*, 31 UCLA L. REV. 72, 76 (1983) (examining litigation as "the process as the investment of scarce resources to achieve a future result").

[261] *See generally* Jonathan T. Molot, *A Market in Litigation Risk*, 76 U. CHI. L. REV. 367, 369 (2009).

[262] Shepherd & Stone, *supra* note 16, at 923–24; Molot, *supra* note 17, at 369–70.

[263] *See* Restatement (Third) of the Law Governing Lawyers § 38, cmt. e (2000) ("Under a contingent-fee contract, however, a client who does not prevail is not liable to the lawyer for court costs and litigation expenses, unless the client agreed to pay them or nonrefundable advances by the lawyer of such costs and expenses are unlawful in the jurisdiction.").

filing fees.[264] The lawyer only gets paid on the back end, receiving a percentage of the recovery — usually between 30% and 40% — if the case succeeds.[265] But the lawyer receives nothing if the case fails.

Contingency fee arrangements are a form of third-party financing because lawyers are not parties to the case. These arrangements help solve a client's liquidity or risk-aversion problems. Imagine a small business owner has a breach of contract claim against her supplier, but either does not have enough money to pay a lawyer by the hour to litigate the case, or would rather not commit the company's depleted resources to litigation. Rather than turn away this prospective client, a lawyer may take the case on contingency, financing the case on behalf of the client in exchange for an expectation of payment when the case succeeds.

Where do lawyers get the money they need to litigate contingency-fee cases? Sometimes lawyers use their own money, but other times, they obtain bank loans secured in whole or in part by the law firm's receivables. In this latter scenario, the contingency fee litigation is financed both by the non-party lawyer and, in turn, by a non-party lender such as a bank. The bank expects its loan to be repaid by proceeds from the lawyer's cases.

Contingency fees were once outlawed under the ancient doctrines of champerty and maintenance, but those days are long over.[266] Indeed, the legal ethics rules expressly *permit* lawyers to take most types of cases on contingency, requiring only that the lawyer's percentage recovery cannot be excessive.[267] And contingency fee arrangements are frequently lauded as positive contributions to our legal system, for they allow claimants to advance meritorious claims even if they do not personally own sufficient resources to vindicate their legal rights.[268]

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[264] *See* Restatement (Third) of the Law Governing Lawyers § 36(2) (2000).

[265] *See* David A. Hyman et al., *The Economics of Plaintiff-Side Personal Injury Practice*, 2015 U. ILL. L. REV. 1563, 1566–68 (2015).

[266] Michael K. Velchik & Jeffrey Y. Zhang, *Islands of Litigation Finance*, 24 STAN. J. L., BUS., & FIN. 1, 20–22 (2019).

[267] *See* ABA Model Rule 1.5(c) ("A fee may be contingent on the outcome of the matter for which the service is rendered, except in a matter in which a contingent fee is prohibited by paragraph (d) or other law.").

[268] *See, e.g.*, Issachar Rosen-Zvi, *Just Fee Shifting*, 37 FLA. ST. U. L. REV. 717, 727 (2010).

Contingency fee agreements are a close cousin of commercial litigation finance.[269] In both instances, someone who is not a party to the litigation agrees to front the costs of litigation in exchange for a share of case recoveries on the back end. Contingency fee financing, like commercial litigation financing, is non-recourse, in that the financier receives payment only if the case succeeds. Indeed, most commercial litigation finance agreements have a lawyer's contingency fee agreement baked into them, because funders typically finance only a portion of the lawyer's fees, asking the lawyer to fund the balance of the fees on contingency.

2. PUBLIC INTEREST ORGANIZATION LITIGATION

Public interest pro bono litigation is also a form of third-party financing. "Because financing litigation—particularly Supreme Court litigation—is well outside the means of the average citizen, civil liberties require coordination among funders to effect social change."[270] Public interest organizations like the NAACP, the ACLU, and the Rockefeller Foundation frequently provide free representation, paying an individual's legal fees and expenses on the client's behalf.[271]

Litigation by public interest organizations may come in two forms. First, the pro bono group's primary objective may be to set favorable legal precedent in an area. For example, an advocacy group may finance an individual's test case to establish a constitutional or statutory right that it hopes will apply to a broad class of individuals. In these instances, the advocacy group certainly wants to obtain victory for the named plaintiff, but its primary goal is to set legal precedent, usually at the appellate level, for a wide class of individuals. In this category of cases, the organization will often be disinclined to accept an early settlement that would resolve the case before it goes up on appeal.

Second, pro bono litigation may be designed primarily to achieve a favorable outcome for a particular client, with little regard to or expectation of setting favorable court precedent. For example, an immigrant-rights group may pay the legal costs of a refugee's application for asylum, with the principal goal being to

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[269] Velchik & Zhang, *supra* note 22, at 19 (classifying contingency fee arrangements as a form of third-party financing); George Steven Swan, S.J.D., *Economics and the Litigation Funding Industry: How Much Justice Can You Afford?*, 35 NEW ENG. L. REV. 805, 834 (2001) (describing contingency fee arrangements as an "economic precedent for the nascent litigation funding industry").

[270] Velchik & Zhang, *supra* note 22, at 17.

[271] *Id.*

obtain relief for the particular client, not to litigate the case all the way to the United States Supreme Court. Similarly, an anti-death-penalty group may be more interested in sparing a death row inmate from execution than setting favorable precedent at the appellate courts.

Litigation sponsored by public interest organizations amounts to third-party financing because it allows an individual to advance a legal claim by relying on a third party to pay the often considerable fees and costs associated with bringing that claim.[272] Pro bono financing is frequently provided on behalf of the indigent, who lack the ability to hire lawyers to vindicate their legal rights. Even if the third-party public interest organization does not have a direct financial interest in the case, it may have an indirect financial interest, and it will certainly have a strong ideological interest in achieving a particular outcome.

Notably, pro bono litigation, like contingency fee litigation, was once attacked as violating the doctrine of maintenance.[273] For example, during the Jim Crow era, some southern states reinforced their existing maintenance and champerty statutes to impede the efforts of advocacy groups like the NAACP to bring civil rights litigation on behalf of poor African-Americans. It took a series of judicial decisions, most famously the Supreme Court's landmark *NAACP v. Button*, 371 U.S. 415 (1963), to defeat those lamentable efforts.[274]

3. Financing claims of friends, family, and employees

Another broad category of third-party funding occurs when an individual or entity pays the legal fees on behalf of someone they know, either through a family relationship, friendship, or employment relationship. For example, generous-minded individuals often pay legal fees on behalf of less-well-off family members or friends. The classic example is a parent who pays her adult child's divorce fees, or a wealthy benefactor who helps a friend who was injured in a car accident bring a civil claim against the reckless driver. While the financier typically does not expect a share of case proceeds in return, each of these examples amounts to a third party financing someone else's legal expenses.

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[272] *Id.*

[273] *See id.* at 18.

[274] *See id.*

In other instances, an employer may agree to finance the litigation costs incurred by an employee for actions the employee took on the job. The employer sometimes has a contractual duty to pay the litigation expenses and even to indemnify the employee for damages. For example, companies frequently pay the legal defense costs of directors or officers sued in their personal capacity for a breach of fiduciary duty. Similarly, state and federal governments typically pay the legal defense costs of officers sued for violations of constitutional rights under 42 U.S.C. § 1983 or *Bivens v. Six Unknown Named Agents of Federal Bureau of Narcotics*, 403 U.S. 388 (1971).

These arrangements are so commonplace that the legal ethics rules expressly contemplate and permit them too. In particular, ABA Model Rules 1.8 and 5.4 expressly permit lawyers to be paid their fee by someone other than the claimholder, notwithstanding the potential conflict of interest where the client's interests may diverge from the interests of the third party paying those legal fees.[275] The rules do not ban these potentially beneficial arrangements — they simply require that, in this circumstance, there may be "no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship."[276]

One possible distinction between commercial litigation funding and the employer- or family-based funding is that the commercial litigation funder has a direct financial stake in the outcome through a right to a share of case proceeds. But an employer or benefactor paying a litigant's legal fees may also have a financial stake in the outcome. For example, an employer may be directly or indirectly on the hook for any damages award against its employee, as is frequently the case for government employees. Benefactors may feel the need to financially support their friend or family member if that person is unable to recover sufficient funds in the litigation. And even if they do not have financial interests in the case, employers may have a strong interest in the legal outcome of

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[275] ABA Model Rule 1.8(f) ("A lawyer shall not accept compensation for representing a client from one other than the client unless: (1) the client gives informed consent; (2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and (3) information relating to representation of a client is protected as required by Rule 1.6."); ABA Model Rule 5.4(c) ("A lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services.").

[276] ABA Model Rule 1.8(f); *see also* ABA Model Rule 5.4, Cmt. [2].

the case, for the precedent set in the litigation may affect the employer's broader commercial or legal interests, while benefactors paying the legal costs of friends and family will certainly be emotionally invested in the case outcome.

4. Equity- or debt-based financing

When companies need money to launch a new product, expand into a new territory, or open a new marketing channel, they can find that money in their bank account, or they can raise the funds they need in the capital markets. Companies typically raise this money by selling *equity* (selling someone else an ownership interest in the company) or issuing *debt* (raising funds that must be paid back at a certain rate of return over time).[277] Few companies are able to self-finance their growth from Day One, so equity and debt financing are integral parts of the capital market system that allows our economic system to flourish.

When companies raise funds for general corporate purposes, one of those purposes may be to finance litigation. Litigation funders frequently meet with claimholders who took out loans against their business, or even mortgaged their property, to finance the cost of litigation, before they learned about commercial litigation finance. Sometimes the litigant secured equity or debt financing primarily for the purpose of using that money to finance litigation, and sometimes they had mixed motives — a little bit of the money would go to pay their lawyers, the rest to build a new plant or hire new workers.

While debt financiers often ask for collateral besides the proceeds of litigation, third-party investors or creditors frequently expect that the successful outcome of pending litigation will provide some or all of the resources that will make their investment a success. Like the contingency fee lawyer — and like the commercial litigation funder —these investors and creditors provide money to a corporation, expecting that part of their financing will be used to cover the costs of litigation, and further expecting that the return on their investment will come, in whole or in part, from litigation proceeds.

And as previously noted, it is not simply claimholders but also lawyers themselves who frequently obtain third-party debt-financing. While the ethics

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[277] *See generally* Katherine Pratt, *The Debt-Equity Distinction in a Second-Best World*, 53 VAND. L. REV. 1055, 1059–60 (2000).

rules prohibit non-lawyers from owning an equity stake in a law firm,[278] contingency-fee lawyers frequently obtain bank loans backed in whole or in part by the firm's receivables. Third-party lenders to law firms thus effectively finance litigation to which they are not a party, with the expectation of obtaining their return on investment from the litigation.

II. IMPLICATIONS FOR DISCLOSURE

Although modern commercial litigation finance improves litigants' ability to access the courts, it has not received universal praise. Opponents of litigation finance, including the United States Chamber of Commerce's Institute for Legal Reform and some legislators, have attempted to limit the spread of litigation finance. As noted, they have pushed for the *automatic* disclosure of litigation finance agreements to both the court and defendants at the outset of litigation, without regard to whether those documents are relevant to the case, whether disclosure would be proportional, or whether the documents are protected by a legal privilege like the attorney-client privilege or the work product doctrine.

Proponents of mandatory disclosure advance a host of arguments to further their push for mandatory disclosure. This essay does not provide every possible response to those arguments. Instead, I highlight one crucial flaw: the arguments for mandatory disclosure of litigation funding can equally be used to support mandatory disclosure of the various forms of third-party financing just discussed — yet the law generally does not require automatic disclosure of these other mechanisms of third-party financing. Indeed, although some of these financing methods may be revealed during discovery after a showing of relevance and proportionality, many of us would bristle at the notion that they should always and everywhere be automatically disclosed at the outset of litigation. Just as we have long recognized that mandatory disclosure of these various other forms of arrangements is not necessary, there is no reason to require mandatory disclosure of commercial litigation finance.

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[278] ABA Model Rule 5.4. Arizona recently became the first state to repeal Rule 5.4 and allow nonlawyer ownership of law firms. Sam Skolnik, *Arizona First State to OK Nonlawyer Ownership of Law Firms*, BLOOMBERG LAW (Aug. 28, 2020), https://bit.ly/2ZypdqZ

1. LAWYER-CLIENT CONFLICTS OF INTEREST

One of the leading arguments offered in favor of mandatory disclosure of litigation funding agreements is that litigation funders may create conflicts of interest for lawyers, inducing them to violate various ethical rules. One leading flavor of this argument, advanced by the Chamber of Commerce, is that litigation finance presents a "threat ... to the plaintiff's right to control his or her own claim" and creates "[t]he possibility of conflicts of interest among the plaintiff, the attorney, and the funder."[279] The Chamber has argued, without evidence, that funders might control litigation strategy or demand that counsel give fealty to the funder, putting the funder's interests above those of the claimholder.

To be sure, we can dispute the premise of this argument. Reputable litigation finance companies scrupulously adhere to the ethics rules and do not control litigation. But even assuming this were a legitimate concern, a comparable theoretical threat is present in just about all of the third-party financing agreements discussed in Part I.

Consider the contingency fee arrangement. Commentators have long recognized that "contingent fees in some situations may cause lawyers' and clients' interests to conflict."[280] Because a lawyer's contingency fee typically remains the same regardless of how much time and effort the lawyer invests in the case, a lawyer has an incentive "to work fewer hours on a case than a fully knowledgeable client paying an hourly rate would choose to have the lawyer work."[281] Likewise, a lawyer may have a financial incentive to settle a case early, potentially for a lower-than-optimal amount for her client, before investing a substantial amount of time and money in the case.[282] Some also argue that lawyers working on a contingency may be more likely to engage in unethical litigation conduct than those working on an hourly rate, since their ability to put bread on the table depends upon winning the case.[283]

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[279] Chamber Letter, *supra* note 1, at 14, 16.

[280] Richard W. Painter, *Litigating on a Contingency: A Monopoly of Champions or a Market for Champerty?*, 71 CHI.-KENT L. REV. 625, 670 (1995).

[281] *Id.* at 671.

[282] *Id.*

[283] 1 The Royal Commission on Legal Services, Final Report 177, 176–77 (1979) ("The fact that the lawyer has a direct personal interest in the outcome of the case may lead to undesirable practices including the construction of evidence, the improper coaching of witnesses, the use of professionally partisan expert

In other words, the argument that litigation finance may create conflicts of interest between claimholder, funder, and lawyer applies with at least as much force to contingency fee arrangements. In fact, the concern about conflicts is arguably *stronger* when attorneys work purely on a contingency, because the attorney gets paid nothing unless the case succeeds. Litigation finance mitigates this potential conflict. That's because in the most common form of litigation finance arrangement, the funder pays half or more of the lawyer's billable hours, giving the lawyer a steady stream of income throughout the case. Because litigation finance agreements allow lawyers to be compensated for a significant portion of the hours they bill on a case, funding mitigates a lawyer's incentive to minimize time spent on a case or to settle for a suboptimal amount early in the case.

A similar analysis applies to other forms of third-party financing. Imagine, for example, that an employer is paying an employee's legal fees. Imagine further that the employer is a longstanding client of the lawyer, but the lawyer does not have a long-term relationship with the employee. It is easy to see a potential threat to the lawyer's professional independence, as the lawyer may be tempted to satisfy the employer's desires rather than zealously represent the employee's interests. A similar dynamic can occur where a parent is paying for her child's divorce costs, or a generous benefactor is financing a friend's medical malpractice claim. If a third party holds the purse strings, a lawyer must be careful to resist the temptation to follow the third-party funder's wishes over those of her client.

Conflicts may also arise in pro bono litigation, particularly in "cause" litigation where the third-party financier does not simply seek relief for the named plaintiff but wants to establish favorable precedent, often at the appellate court or Supreme Court level. It is no secret that "political and ideological goals, rather than strictly monetary ones, often motivate clients in public interest cases."[284] Imagine, for example, that a union wishes to fund litigation on behalf of one of its employees. As the litigation progresses, the employee may wish to accept a generous settlement offer from the defendant, but this desire may conflict with the union's

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witnesses (especially medical witnesses), improper examination and cross-examination, groundless legal arguments designed to lead the courts into error and competitive touting"), *quoted in* Painter, *supra* note 36, at 668.

[284] Susan D. Carle, *The Settlement Problem in Public Interest Law*, 29 STAN. L. & POL'Y REV. 1, 4 (2018).

desire to keep litigating the case in the hope of establishing favorable precedent.[285] Will the lawyer's advice to the employee be shaded by the lawyer's knowledge that the paying client — the union — wants to establish "the law of the land," or by the lawyer's own desire to be involved in a precedent-setting case? Ideological motivations can be stronger than monetary ones, and the fact that the third-party funder does not stand to immediately gain financially from a favorable outcome does not eliminate the possibility of a conflict.

Our legal system takes these threats to a lawyer's independence seriously — but it does not deal with these threats by requiring mandatory disclosure whenever a third party is paying the attorney's legal fees, or by requiring lawyers to disclose whenever they are working on a contingent fee. Instead, we trust lawyers to satisfy their ethical duties to maintain their independence and place the interests of their clients first, without allowing opposing counsel to peer over their shoulder to monitor compliance. For example, Model Rule 5.4(c) permits third parties to pay a lawyer's legal fees, but it provides that "[a] lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services." Likewise, lawyers may work on a contingency fee, but when they do, they must maintain professional independence and put their clients' interest first.

The question for proponents of mandatory disclosure is why lawyers can be trusted to maintain their independence in all these other areas — contingency fee arrangements, third-party payor arrangements, pro bono litigation, and so on — but not in the context of commercial litigation finance. It is hard to see a satisfying answer, particularly where these other instances of third-party funding present at least as great, or even greater, theoretical conflicts of interest. Indeed, litigation finance companies, as repeat players in the market for legal services, have particularly strong incentives to adhere closely to the ethical rules requiring attorney independence, lest they garner a poor reputation in the market or bring the litigation finance profession into disrepute.

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[285] *See id.* at 31–32 (discussing a New Hampshire Bar Association ethics opinion permitting the union to condition its payment for legal services on behalf of an employee on precluding the employee from settling without the union's permission or otherwise requiring the employee to reimburse the union for its legal expenses incurred). *See also* N.H. Bar Ass'n Ethics Comm., *Control of Settlement by Third Party Paying the Lawyer's Fees,* (Dec. 8, 1993).

2. UNETHICAL ATTORNEY FEE ARRANGEMENTS

Another argument often presented by proponents of mandatory disclosure is that mandatory disclosure is necessary because litigation finance agreements may violate the ethical rule against fee sharing. ABA Model Rule 5.4, like the analogues in most states, provides that a lawyer generally may not "share fees with a nonlawyer . . . ."[286] A "troubling ethical implication of [litigation finance]," the Chamber of Commerce has speculated, "is the tendency of some lawyers who enter into [litigation funding] arrangements to share their legal fees with the funder."[287] Proponents of mandatory disclosure have thus suggested that mandatory disclosure is necessary to allow a court and opposing party to preemptively check if the plaintiff's lawyer is violating the ethical rule against fee sharing.

As an initial matter, it is important to put this argument in context. Most litigation finance agreements are between the funder and the *claimholder*. These agreements, where the claimholder agrees to give a portion of her case proceeds to the funder, simply do not implicate Rule 5.4's prohibition against fee sharing. Only agreements between the funder and the *law firm* arguably implicate Rule 5.4. Thus what the Chamber's argument would require is not simply disclosure of the *client*'s litigation funding, but of any financing that the *law firm* receives to support its contingency fee practice. That would indeed be a very broad and intrusive requirement, and would seemingly have no stopping point. For example, would a law firm have to disclose its private bank loans, so that counsel from one law firm has an opportunity to scrutinize the finances of its competitor law firm?

In any event, the argument for disclosure based on speculative violations of Rule 5.4 fits poorly with how our legal system polices potential rule violations in connection with the broad range of other third-party financing agreements. Let's assume we can imagine hypothetical litigation finance agreements that may

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[286] ABA Model Rule 5.4(a). As noted, in August 2020 Arizona became the first state to eliminate Rule 5.4. Meanwhile, Utah has created a regulatory sandbox to allow nonlawyer ownership of law firms on a provisional basis, and other jurisdictions are looking at eliminating Rule 5.4 too. *See* Lyle Moran, *Utah embraces nonlawyer ownership of law firms as part of broad access-to-justice reforms*, ABA J. (Aug. 14, 2020), https://bit.ly/35wy5RB

[287] Chamber Letter, *supra* note 1, at 13.

violate the ethical rule against fee sharing. So too can we conjure other financing agreements that may violate ethical rules.

For example, contingent fee arrangements must be reasonable and not excessive.[288] But some contingency fee agreements may be unreasonable and excessive. Should contingency fee arrangements therefore be subject to mandatory disclosure?

Likewise, the model rules prohibit contingency fee arrangements in criminal cases, or in domestic relations cases where the lawyer's payment is contingent upon securing a divorce or a particular amount of alimony or support.[289] But some lawyers may enter into prohibited contingency fee agreements in these cases. Should litigants be required to disclose at the outset of litigation their retainer agreements in any criminal or domestic relations matter?

Once again, our legal system addresses potential violations of the ethical rules by trusting lawyers to enter into ethical fee agreements that comply with the lawyer's professional responsibilities. Lawyers are not required to lodge their retainer agreements with the court so that a judge and opposing counsel may scrutinize the arrangements to ensure that no provision of law or ethics has been violated. Why is litigation finance different? Indeed, if we trust lawyers to enter into ethical fee agreements when lawyers may be unethical about the return *payable to the lawyer*, it is hard to see why we should not trust them to be ethical when it comes to the return payable *to a third party*.

3. JUDICIAL CONFLICTS OF INTEREST

Another argument frequently put forward in support of the mandatory disclosure of litigation finance arrangements is that disclosure is necessary to avoid a possible judicial conflict of interest. The Chamber of Commerce has suggested that judges might have invested in litigation finance companies, or hedge funds operating as litigation funders, and disclosure is necessary for the judge to determine if she must recuse from the case.[290]

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[288] ABA Model Rule 1.5(c).

[289] ABA Model Rule 1.5(d).

[290] Chamber Letter, *supra* note 1, at 15. *See also* Victoria Shannon Sahani, *Judging Third-Party Funding*, 63 UCLA L. REV. 388, 423, 427 (2016) (advocating *in camera* disclosure of the identity of any funder to judges to determine financial conflicts of interest).

It is hard to believe a judge would find it prudent to invest in one of the few litigation finance companies that is traded on the public markets, much less in a privately held litigation finance company. In fact, it is already improper for judges to do so. The Code of Conduct for United States Judges prohibits judges from having financial or business relationships with "lawyers or other persons likely to come before the court on which the judge serves."[291] State laws typically contain the same prohibition.[292] There is little reasonable basis to assume a judge will have a financial conflict of interest because a litigation funder is involved in a case. And even if such a basis existed, this would justify at most disclosure *in camera* to the court of the identity of any funder — not disclosure to the defendant of both the identity of the funder *and* the funding agreement itself.

Even setting aside these points, the corporate disclosure rules do not require disclosure of every single potential financial or personal conflict of interest, let alone conflicts as phantom as a judge investing in a litigation finance company. For example, the federal rules only require corporate parties to "identif[y] any parent corporation and any publicly held corporation owning 10% or more of its stock."[293] Under these rules, a company need not disclose if another privately held company, or an investor such as a private equity fund or angel investor, has a financial interest in the company — notwithstanding the possibility that a judge might have investments in the private equity firm, or may be friends with the angel investor. For example, before Uber Technologies, Inc., went public, the federal rules only required the company to report in its briefs that it is a "privately held corporation" and that "[n]o parent corporation or publicly held corporation owns 10% or more of its stock" — despite the fact that probably hundreds of individuals or corporate entities (many of whom might be friends with a judge presiding over a case involving Uber) had a financial stake in the company.[294]

The committee notes to Federal Rule of Civil Procedure 7.1 have already resolved this aspect of the disclosure debate — and they have resolved it squarely against the Chamber's argument. Those notes explain that although "the

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[291] Code of Conduct for United States Judges, Canon 4, ¶ D.

[292] *See, e.g.*, N.Y. Judicial Law, Code of Judicial Conduct, Canon 4(D).

[293] FED. R. CIV. P. 7.1; *see also* FED. R. APP. 26.1(a).

[294] *See*, *e.g.*, Appellants' Joint Opening Brief at ii, *Mohamed v. Uber Technologies, Inc.*, No. 15-16178 (9th Cir. Oct. 21, 2015).

disclosures required by Rule 7.1(a) may seem limited, they are calculated to reach a majority of the circumstances that are likely to call for disqualification on the basis of financial information that a judge may not know or recollect."[295] The committee notes further recognize that "[u]nnecessary disclosure requirements place a burden on the parties and on courts," and that "[i]t has not been feasible to dictate more detailed disclosure requirements in Rule 7.1(a)."[296] There is no reason to upset this compromise and create a gerrymander that sweeps in only one additional — and especially unlikely — potential conflict of interest.

This point becomes particularly salient when viewed in light of the various forms of third-party financing arrangements identified above. It is possible that an anonymous benefactor who is friends with the judge has decided to fund a claimholder's case pro bono. It is also possible that a company in which the judge has an interest has provided debt financing to a litigant, with the expectation that the financing will be used at least in part to fund the litigation. But our legal system has not required onerous disclosures to catch these hypothetical but highly unlikely conflicts. It is hard to see why the extraordinary disclosure of litigation finance agreements is necessary when it presents at best a comparable likelihood of leading to a judicial conflict of interest than various other relationships for which we have not required mandatory disclosure.

4. AVOIDING VIOLATIONS OF CHAMPERTY AND MAINTENANCE LAWS

Another argument often advanced to prop up arguments for mandatory disclosure is that litigation funding agreements may violate the hoary prohibitions against champerty and maintenance. Champerty prohibits what Blackstone called "officious intermeddling in a suit that no way belongs to one, by maintaining or assisting either party, with money or otherwise," in return for a portion of case proceeds.[297] The Chamber argues that "if a party is being sued pursuant to an illegal (champertous) funding arrangement, the defendant has a right to know and presumably would have standing to challenge such an agreement as champertous under the applicable state law."[298]

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[295] Committee Notes on Rule, 2002, FED. R. CIV. P. 7.1.

[296] *Id.*

[297] 4 W. BLACKSTONE, COMMENTARIES *134–36. *See also In re Primus*, 436 U.S. 412, 424 n.15 (1978).

[298] Chamber Letter, *supra* note 1, at 13.

As an initial matter, the Chamber is wrong to claim that the defendant would have standing to challenge a funding agreement to which it is not a party. To the contrary, courts in almost all jurisdictions hold that defendants do not have standing to challenge allegedly champertous agreements entered into between the plaintiff and a third party.[299] Thus in most jurisdictions, the only party that should be able to challenge the agreement — the funded party — already has full knowledge of the funding contract (because it is a party to that contract). This point alone should dispose of this particular argument for mandatory disclosure.

Moreover, standard commercial litigation finance arrangements simply do not violate the doctrines of champerty and maintenance in most jurisdictions. "The consistent trend across the country is toward limiting, not expanding, champerty's reach."[300] Champerty is on the decline principally because of a growing belief that the doctrine is no longer necessary to cure the perceived evils it was devised to combat. Ethics rules more directly prohibit lawyers from filing frivolous claims or allowing third parties to control litigation. Thus a number of jurisdictions, like Massachusetts, Minnesota, and South Carolina, have entirely abolished champerty.[301] Other states prohibit champerty only insofar as someone "officiously intermeddles" in someone else's litigation to control and gin up frivolous litigation — and the decisions further recognize that funders are generally not officious intermeddlers.[302] Notably, the Chamber has sought mandatory disclosure in all jurisdictions, without regard to whether local law retains vestiges of champerty and maintenance law.

Even so, let us assume that a jurisdiction still recognizes champerty and maintenance, that it is arguable that litigation finance violates these prohibitions, and that a defendant would have standing to challenge that agreement. We can also imagine a whole host of other third-party financing agreements that might

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[299] *See, e.g.*, *Kipperman v. Onex Corp.*, 411 B.R. 805, 886 (N.D. Ga. 2009); *McMullin v. Borgers*, 806 S.W.2d 724, 735 (Mo. Ct. App. 1991); *Cone v. Benjamin*, 27 So.2d 90, 107 (Fla. 1946); *Sibley v. Alba*, 95 Ala. 191, 197-98 (1892).

[300] *Del Webb Communities, Inc. v. Partington*, 652 F.3d 1145, 1156 (9th Cir. 2011).

[301] *Saladini v. Righellis*, 687 N.E.2d 1224, 1226 (Mass. 1997); *Maslowski v. Prospect Funding Partners LLC*, 944 N.W.3d 235, 238 (Minn. 2020); *Osprey, Inc. v. Cabana Ltd. P'ship*, 532 S.E.2d 269, 277 (S.C. 2000).

[302] *See, e.g.*, *Charge Injection Techs., Inc. v. E.I. Dupont De Nemours & Co.*, 2016 WL 937400, at *3–5 (Del. Super. Ct. Mar. 9, 2016); *Odell v. Legal Bucks, LLC*, 665 S.E.2d 767, 775 (N.C. Ct. App. 2008); *Kraft v. Mason*, 668 So.2d 679, 683 (Fla. Dist. Ct. App. 1996).

violate these prohibitions, and especially the prohibition against maintenance, which forbids the mere "intermeddling" in another's suit, regardless of whether the third party will receive a portion of case proceeds in return. For example, a defendant's corporate financing agreements or its outstanding debts, or a civil rights plaintiff's receipt of pro bono funds from a third party may all conjure fact patterns where the champerty or maintenance rules may theoretically be violated.

But these theoretical concerns have not led to the automatic disclosure of any and all financing agreements, so that opposing counsel and courts may investigate whether someone in the case is violating the law. Why should litigation funding be treated any differently? Such idle suspicion of wrongdoing has never been found to warrant discovery — much less mandatory disclosure. As the United States Supreme Court has explained, "[j]udges are trusted to prevent 'fishing expeditions' or an undirected rummaging through bank books and records for evidence of some unknown wrongdoing."[303] New York law specifically requires that discovery must be conducted in a way that "prevent[s] unreasonable annoyance, expense, embarrassment, disadvantage, or other prejudice to any person or the court."[304] It is hard to see why we should depart from this practice for only one form of third-party financing.

5. THE INSURANCE ANALOGY

The Federal Rules of Civil Procedure do require mandatory disclosure of insurance agreements where an insurer may be liable for any judgment against defendants.[305] Some opponents of litigation finance have seized on this fact, arguing that mandatory disclosure of litigation finance is necessary to eliminate the "current inequity" in the federal rules, whereby "defendants [are] required to disclose to opposing counsel their contracts with insurers, but plaintiffs [are] allowed to keep their funding arrangements under wraps."[306]

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[303] *Cuomo v. Clearing House Ass'n, L.L.C.*, 557 U.S. 519, 531 (2009).

[304] N.Y. CPLR § 3103(a).

[305] FED. R. CIV. P. 26(a)(1)(iv).

[306] Letter From 30 In-House General Counsels to Rebecca A. Womeldorf, Secretary of the Committee on Rules of Practice and Procedure of the Administrative Office of the United States Courts at 1–2 (Jan. 31, 2019).

The focus on the disclosure requirement for insurers ignores the many other forms of third-party financing discussed above where mandatory disclosure is *not* required. The world does not consist of only two types of third-party financing — i.e., insurance and commercial litigation finance. And the vast majority of third-party funding arrangements are *not* subject to mandatory disclosure. If plaintiffs were required to disclose their commercial litigation finance agreements, true "equity" would occur only if defendants were required to disclose all of their debt and equity sources of capital, and other plaintiffs were required to disclose any third-party funding or the terms of their lawyer's contingency fee arrangements. This would require a sea-change in our current mandatory disclosure regime.

The fact that insurance obligations must be disclosed speaks to the unique nature of defense-side insurance; it does not provide an argument for disclosure of other forms of third-party financing, including but not limited to commercial litigation finance. The comments to Federal Rule 26 make this point explicit and rebut any parallel between insurance and litigation funding. Those comments explain that insurance is unique because "insurance is an asset created specifically to satisfy the claim," "the insurance company ordinarily controls the litigation," "information about coverage is available only from defendant or his insurer," and "disclosure does not involve a significant invasion of privacy."[307]

None of these observations is true about litigation finance. Litigation funding is created *after* (not before) the claim exists. Funding does not exist to satisfy the claim — instead, it simply provides financing to the claimholder, usually to meet the legal fees and costs necessary to advance the claim. Funders do not control litigation. And disclosure would involve a very significant invasion of privacy and disclose key strategic information about the plaintiff's litigation strength.

This last point gets to the heart of the disclosure debate. Mandatory disclosure tells a defendant at least two critical pieces about the plaintiff's case. First, it discloses *whether* the plaintiff has funding — revealing both the strength of those plaintiffs who have funding, and the weakness of those who do not. Second, it discloses *how much* funding the plaintiff has — giving defendants great leverage once they know that plaintiffs are running out of funds. For example, if the defendant knows that the plaintiff has $2,000,000 in funding, the defendant has

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[307] Fed. R. Civ. P. 26, Notes of Advisory Committee on Rules — 1970 Amendment.

a lot of leverage to reject a settlement offer proffered right about the time the defendant estimates the plaintiff has burned through that litigation budget.

III. CONCLUSION

While commercial litigation finance companies may be new, third-party financing of legal claims is not. Some of the most bedrock features of our civil justice system, including contingency fee litigation and pro bono litigation, are instances where third parties finance the often extraordinary costs of litigation. Other forms of third-party financing are less obvious but no less real, including third-party finance by employers, family, and friends, and even the raising of debt or equity. Sometimes the purpose of third-party financing is to obtain a portion of case proceeds or to achieve some other financial incentive, sometimes the funder seeks a "dividend" in the form of favorable legal precedent, and sometimes the funder simply wants to help someone else vindicate her legal rights.

This insight has important implications for the debate about mandatory disclosure of litigation finance agreements. Opponents of litigation finance have advanced various reasons for requiring mandatory disclosure, including fear that funding agreements will impair attorney independence, will enact unethical fee arrangements, will create judicial conflicts, or will violate legal prohibitions against champerty and maintenance. But these arguments apply with at least as much force, if not more, as the other forms of third-party finance discussed in this essay. There is no reason to require mandatory disclosure of litigation finance agreements, even as we have long recognized that mandatory disclosure of these various other forms of arrangements is not necessary.

Commercial litigation finance is a relatively modern development, but it has deep roots in our civil justice system. It is simply the latest in a long line of developments that have permitted increased access to the courts. There is no reason to uniquely shackle this one of many various forms of third-party financing.

Hey, Big Spender: Ethical Guidelines for Dispute Resolution Professionals when Parties Are Backed by Third-Party Funders

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First published by *Arizona State Law Journal*, Volume 51, Issue 1

A man without ethics is like a wild beast loosed upon this world.
— Albert Camus

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INTRODUCTION

This first-of-its-kind paper introduces ethical guidelines and suggested practices for dispute resolution providers and neutrals when third-party funders provide financial backing for parties in U.S. domestic arbitrations and mediations.[308] Sophisticated third-party funders have realized that litigation and dispute resolution are fast-growing, unregulated investment opportunities.[309] Seizing these opportunities, third-party funders are now making billions of dollars in profits through their strategic investments in domestic and global litigation and dispute resolution with few ethical rules or regulations to curtail their investment behavior.[310] Preferring to be secretive about the terms of their funding contracts and invisible in their work, third-party funders are flourishing, in large part, by operating below the regulatory radar.[311] The funders' behavior has been allowed

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[308] *See* LISA BENCH NIEUWVELD & VICTORIA SHANNON SAHANI, THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION 129–74 (Wolters Kluwer 2d ed. 2017); Memorandum from Patrick A. Tighe, Rules Law Clerk to Ed Cooper et al. (Feb. 7, 2018), *in* ADVISORY COMM. ON CIVIL RULES, AGENDA BOOK 209, 215 (2018), http://www.uscourts.gov/sites/default/files/2018-04-civil-rules-agenda-book.pdf [https://perma.cc/K9EB-QL3B]. Domestically, states have taken an inconsistent approach regarding third-party funding as evidence by states' statutes, case law and rules. Those states that have adopted any rules and regulations focus on disclosure in litigation and the boundaries of permissible funding arrangements. None of these rules and regulations address the ethical issues for dispute resolution providers and neutrals that arise when a party is receiving third-party funding.

[309] *See* John Breslin, *Funding Litigation a Billion-Dollar Business*, LEGAL NEWSLINE (Aug. 30, 2017), http://legalnewsline.com/stories/511198462-funding-litigation-a-billion-dollar-business [https://perma.cc/6XZH-GHJT]; Vanessa O'Connell, *Funds Spring Up to Invest in High-Stakes Litigation*, WALL ST. J. (Oct. 3, 2011), https://www.wsj.com/articles/SB10001424052970204226204576598842318233996 [https://perma.cc/69VW-ATNM].

[310] *See, e.g.*, sources cited *supra* note 1; *see also* Matthew Andrews, *The Growth of Litigation Finance in DOJ Whistleblower Suits: Implications and Recommendations*, 123 YALE L.J. 2422, 2428–29 (2014) (discussing how litigation funding is a lucrative, growing industry that invests in a range of cases including personal injury, employment discrimination, intellectual property, and other commercial disputes); GEOFFREY MCGOVERN ET AL., RAND INST. FOR CIVIL JUSTICE, THIRD-PARTY LITIGATION FUNDING AND CLAIM TRANSFER: TRENDS AND IMPLICATIONS FOR THE CIVIL JUSTICE SYSTEM 12 (2010), https://www.rand.org/pubs/conf_proceedings/CF272.html [https://perma.cc/QA2Z-J7U7] (reporting that third-party funding is a multibillion dollar industry).

[311] *See* NIEUWVELD & SAHANI, *supra* note 1, at 159–73 (indicating a growing minority of states that have statutes requiring disclosure in the litigation context); *see, e.g.*, Maya Steinitz, *Whose Claim Is This Anyway? Third-Party Litigation Funding*, 95 MINN. L. REV. 1268, 1277–78 (2011) ("In international arbitrations, the reason for this expansion [of third-party funding] is partly a de facto absence of professional regulations that enables funders and attorneys to operate outside of the disciplinary reach of bar associations.").

to proceed invisible and unchecked because courts and dispute resolution providers and neutrals are too often unaware that a party is even receiving third-party funding. Such unawareness, however, presents a potential ethical minefield, not just for judges and litigators, but also for dispute resolution providers and neutrals.

A discordant chorus of courts,[312] business gurus[313] and legal scholars, slowly becoming aware of the potential ethical conflicts, have begun to voice concerns that third-party funders may be traversing proscribed ethical boundaries involving the practice of law. This growing group is calling for greater visibility, transparency and ethical scrutiny of third-party funding practice in litigation. Of course, when parties disagree, courts are the final arbiter of whether or not the practice of third-party funding is even legal.[314] However, once courts resolve the threshold issue of legality, there is growing support among the judiciary and legal community to require litigants to disclose if they are receiving economic support by a third-party funder.[315] Without such mandatory disclosure our legal system is

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[312] *Compare* Alison Frankel, *New York's Top Court Clamps Down on Shoestring Litigation Funders*, REUTERS (Oct. 28, 2016, 1:50 PM), http://www.reuters.com/article/us-frankel-litigation/new-yorks-top-court-clamps-down-on-shoestring-litigation-funders-idUSKCN12S2M3 [https://perma.cc/36TD-APAL] (describing recent N.Y. Court of Appeals decision that expanded the reach of champerty), *and* Kevin LaCroix, *Courts Throw Some Shade at Litigation Funding Arrangements*, D&O DIARY (Oct. 9, 2016), http://www.dandodiary.com/2016/10/articles/litigation-%20financing-2/courts-throw-shade-litigation-funding-arrangements/ [https://perma.cc/CA9H-H46P] (describing cases in which funding arrangements were recently nullified in both Pennsylvania and Delaware), *with Digging Didn't Help—Court Decision Supports Commercial Litigation Funding*, BENTHAM IMF (Feb. 12, 2014), http://www.benthamimf.com/blog/blog-full-post/bentham-imf-blog/2014/02/12/digging-didn't-help---court-decision-supports-commercial-litigation-funding [https://perma.cc/8EWV-QMEP] (describing recent decision in the Northern District of Illinois that held confidential communications between party and funder were protected by work product doctrine).

[313] *See* Alison Frankel, *Business Lobby Calls for Federal Rules to Require Litigation Funding Disclosure*, REUTERS (June 2, 2017, 11:55 AM), http://www.reuters.com/article/us-otc-funding-idUSKBN18T2QR [https://perma.cc/UT2R-RJE7]. More than two dozen business groups including the U.S. Chamber of Commerce are advocating that the Federal Rules of Civil Procedure be modified to require parties to disclose if they are backed by third-party funders.

[314] *See* AM. BAR ASSOC. COMM'N ON ETHICS 20/20, INFORMATIONAL REPORT TO THE HOUSE OF DELEGATES 1 (2012), https://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111212_ethics_20_20_alf_white_paper_final_hod_informational_report.pdf [https://perma.cc/RS55-PQK4] [hereinafter ABA 20/20 REPORT].

[315] *See* Dorothy Murray & Edmund Northcott, *Thoughts on Disclosure of Third Party Funding*, LEXOLOGY (June 20, 2017), https://www.lexology.com/library/

unable to address the real and potential ethical concerns about how third-party funders are adversely affecting the attorney-client relationship, controlling settlement, and potentially posing conflicts of interest with all involved in the case.

Until now, such heated discourse in the United States about the ethics of third-party funders has focused primarily on the ethics of third-party funding in litigation, while only cursorily addressing the ethical issues of third-party funders in U.S. domestic arbitration, a quasi-litigation procedure.[316] Even more curious, the ethics of third-party funders in mediation, a party-directed procedure, has been conspicuously absent from the conversation. Since the lion's share of legal cases are resolved by dispute resolution settlement rather than court judgment,[317] it makes more sense that any discussion about the ethical conduct of third-party funders should address the ethical conduct of third-party funders in those dispute resolution procedures that help promote settlement. The presence of a third-party funder in a dispute resolution procedure may collide with the ethical obligations of dispute resolution providers and neutrals, unless affirmative steps are taken to

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detail.aspx?g=d01612dd-5a78-4f8a-ae6c-22ba3c064630 [https://perma.cc/VUA6-NVM4]; Jason D. Russell & Hillary A. Hamilton, *Third-Party Litigation Financing: Mandatory Disclosure on the Horizon?*, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP & AFFILIATES (Apr. 19, 2017), https://www.skadden.com/insights/publications/2017/04/thirdparty-litigation-financing-mandatory-discl ("Recent developments indicate that courts, rule committees and even Congress may be leaning toward mandatory disclosure of third-party litigation funding in civil litigation."). *But see* Sam Reisman, *Critics Pushing Back on 3rd-Party Funding Disclosure Rule*, LAW360 (June 21, 2017, 7:08 PM), https://www.law360.com/articles/935786/critics-pushing-back-on-3rd- party-funding-disclosure-rule [https://perma.cc/WW6H-XWXZ].

[316] Our global brethren, however, have addressed the ethics of third-party funding in the context of international arbitration. This is discussed later in the section. *See generally* INT'L COUNCIL FOR COMMERCIAL ARBITRATION, REPORT OF THE ICCA-QUEEN MARY TASK FORCE ON THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION (2018), http://www.arbitration-icca.org/media/10/40280243154551/icca_reports_4_tpf_final_for_print_5_april.pdf [https://perma.cc/A27G-P34A] [hereinafter ICCA REPORT]

[317] *See* Marc Galanter, *The Vanishing Trial: An Examination of Trials and Related Matters in Federal and State Courts*, 1 J. EMPIRICAL LEGAL STUD. 459, 461 (2004); Patricia Lee Refo, *The Vanishing Trial*, 30 LITIG., Winter 2004, at 2 (2004), https://www.americanbar.org/content/dam/aba/publishing/litigation_journal/04winter_openingstatement.authcheckdam.pdf [https://perma.cc/W9X6-QXGX] (stating that approximately 1.8% of federal cases were actually decided by an adjudicated decision).

avoid the collision.[318] This paper fills in that information gap, expands the evolving discussion about the ethics of third-party funding, and refocuses on providing ethical guidance for dispute resolution providers and neutrals when litigation funders back parties in arbitration and mediation.

Our global brethren, who have long embraced litigation funding as an economic necessity to fund the escalating costs of litigation, have also begun to heed this warning and promulgate ethical rules to guide third-party funders' behavior in dispute resolution.[319] Globally, there are now legislative and regulatory initiatives that require greater transparency when litigation funders are providing financial backing for parties in international arbitration and mediation.[320] In the United States, however, there is ambivalence about the legitimacy of litigation funding.[321] This paper is the first proposal for coordinated ethical guidelines for alternative dispute resolution providers and neutrals to follow when third-party funders are backing parties in domestic arbitration and mediations.

In order to develop responsive ethical guidelines for working with third-party funders in dispute resolution, we must first grasp the complexities and nuances of third-party funders, and this paper provides that context. Part I chronicles the evolutionary role of third-party funders. It explains who third-party funders are, why they were once prohibited, and the many permutations in which they now exist. Part II provides an overview of two global initiatives that provide ethical guidance when litigation funders are backing parties in a dispute resolution procedure. Even though global legal regimes present different ethical challenges, it is instructive to take the international pulse on this emerging issue and see which ideas can be transported to the United States.

In Part III, the discussion focuses on the U.S. response to third-party funders by highlighting notable court decisions, the American Bar Association's Commission on Ethics 20/20 report, and public interest research on this emerging topic. Part III helps identify the U.S. areas of agreement and concern that need to be incorporated into any ethical guidelines and best practices for dispute resolution providers and neutrals. Part IV outlines suggested ethical guidelines and best

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[318] *See* Victoria Shannon Sahani, *Reshaping Third-Party Funding*, 91 TUL. L. REV. 405, 426–28 (2017).

[319] *See generally* ICCA REPORT, *supra* note 9.

[320] *See generally id.*

[321] *See* NIEUWVELD & SAHANI, *supra* note 1, at 157.

practices for dispute resolution providers, arbitrators, and mediators to follow when parties are receiving third-party funding. This discussion concludes by recognizing that this paper is an overdue acknowledgment that third-party funders are backing parties in dispute resolution procedures and a recognition that additional ethical issues will emerge. The reader is left with additional questions that the dispute resolution community may want to consider as third-party funders continue to play an evolving role in dispute resolution.

I. THE EVOLVING ROLE OF THIRD-PARTY FUNDERS

The narrative about how third-party funding has evolved from a proscribed practice to an economic reality sheds light on the vestiges of concern about third-party funders that persist today. It also provides a historical context for readers to better understand the ethical concerns that should be addressed when third-party funders are backing a party in a dispute resolution mechanism.

Historically, legal systems have had a long-standing antagonism towards those third parties who try to inject themselves into the litigation of others. In large part, courts believed that adjudication should involve only the litigants and the judge, and courts feared that those outsiders who attempt to inject themselves in these legal proceedings do so solely because they have a nefarious purpose that would subvert the integrity of the justice system.[322] Such a hostile intrusion was considered harmful to both the individual litigants and the system as a whole. As you will read, that fear was founded. In legal systems dating back from ancient Greek and then Roman times, there was a commitment to safeguard justice by barring any outsider who attempted to inject himself between the litigants and the judge.[323] These outsiders took different forms. In the fifth and fourth centuries B.C., there were political clubs, known as sycophants, who would ban together and

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[322] *See* Marc DeGirolami, *On the Intellectual Origins of the Crime of Barratry*, MIRROR JUST. (Nov. 18, 2010), https://mirrorofjustice.blogs.com/mirrorofjustice/2010/11/on-the-intellectual-origins-of-the-crime-of-barratry.html [https://perma.cc/9BNJ-NAW7] (describing how champerty harmed the individual client and the legal system as a whole).

[323] Max Radin, *Maintenance by Champerty*, 24 CALIF. L. REV. 48, 50 (1935). There was a recognized primacy in the relationship between the litigants and the judge. *Id.* The litigant spoke directly to the judge. *Id.* Family and friends were encouraged to attend the court proceedings only as providers of moral support for the litigant. *Id.* It was considered a "serious fraud on the court" if a stranger attended, pretending to be a friend of the litigant. *Id.*

provoke litigation against their political adversaries.[324] Similar to the Greek sycophant, Romans had the calumniator—those who commenced baseless litigation for the sole purpose of agitating the government.[325]

This suspicion towards the intervention of outsiders to litigation continued into the Middle Ages and was codified into both the common law and old English statutes.[326] Barratry, champerty and maintenance are the codifications of three categories of proscribed interference into the legal system.[327] Barratry described the offense of those agitators who would provoke legal disputes.[328] Maintenance is the general term used to describe when an outsider to the litigation advances money to support an ongoing litigation without receiving a portion of the outcome.[329] Champerty, a type of maintenance, refers to an outsider to the litigation who advances money to support litigation with the understanding that he will receive in return for his contribution, a profit or portion of the proceeds.[330]

Over time, as legal systems strengthened their due process procedures to address these concerns, courts, in their wisdom, also began to realize that not all outsiders to litigation were a nefarious group, and that some outsiders even helped advance justice. Thus, a more nuanced approach to outsiders was warranted. In 1886, Judge Thayer in the *Dahms v. Sears* case opined that "[m]any of the evils which the law was intended to remedy have been overcome by countervailing circumstances that have arisen, and, in effect, have been extinguished."[331] With this more nuanced perspective, for example, it was recognized that maintenance could be re-characterized as an altruistic act that promotes social good by providing public interest groups needed funding to bring forward a worthy claim without the funders getting any money in return.[332] Yet even today, as the

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[324] *Id.* at 49–51.

[325] *Id.* at 53.

[326] *See id.* at 57–58; *see also* S.J. Brooks, *Champerty and Maintenance in the United States*, 3 VA. L. REV. 421, 421–22 (1916).

[327]. Brooks, *supra* note 19, at 421.

[328] *Id.* at 423.

[329] *Id.*

[330] *Id.*

[331] *Id.* at 425 (quoting Judge Thayer in *Dahms v. Sears*, 11 P. 891, 898 (Or. 1886)).

[332] Simon Fodden, *Barratry, Champerty, Maintenance, Oh My!*, SLAW (Sept. 20, 2011), http://www.slaw.ca/2011/09/20/barratry-champerty-maintenance-oh-my/ [https://perma.cc/G4K2-XV9N].

following sections illustrate, domestic and global courts still maintain a cautious approach to third-party funders. Vestiges of this mistrust continue to be evidenced in our modern-day law. Such legal doctrines as unconscionability in contract law, usury in consumer law and the laws regarding assignment of claims are examples of continued modern-day vigilance of third-party funders' actions.[333] Fueling this mistrust in part is the difficulty involved in discerning who is a funder and whether the funder is conducting himself within the permissible bounds of the law.

In its most elemental form, third-party funding involves a funding entity who provides financial support to a litigant in return for a share of the proceeds from a settlement or judgment.[334] However, third-party funders come in many forms: banks, hedge funds or individuals or entities that provides funding with the expectation of profits.[335] The variations that exist in different types of third-party funding are determinant in assessing whether the funding typology is legal and has a permissible business purpose.[336] Furthermore, the characterization of a third-party funder is important, because different disclosure and ethical obligations attach to each characterization.[337]

The contract between the funder and the litigant defines the financial relationship between the funder and the funded party, the funder's role in the management of the case, and the allocation of responsibilities between the funder and funded party. Yet, third-party funders resist disclosing these contracts, insisting that the contracts are proprietary.[338] The third-party funding contract varies from recourse to nonrecourse agreements.[339] Furthermore, there is no one

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[333] *See* NIEUWVELD & SAHANI, *supra* note 1, at 136–37, 143–44.

[334] *See* ABA 20/20 REPORT, *supra* note 7, at 1; Victoria Shannon Sahani, *Judging Third-Party Funding*, 63 UCLA L. REV. 388, 392 (2016).

[335] Sahani, *supra* note 27, at 392; ICCA REPORT, *supra* note 9, at 50–51.

[336] *See* Victoria A. Shannon, *Harmonizing Third-Party Litigation Funding Regulation*, 36 CARDOZO L. REV. 861, 877–79 (2015).

[337] *Id.* at 903–04.

[338] *See* Victoria Shannon Sahani, *Blurred Lines Between Third-Party Funders and Law Firms*, KLUWER ARB. BLOG (Nov. 3, 2016), http://kluwerarbitrationblog.com/2016/11/03/blurred-lines-between-third-party-funders-and-law-firms/ [https://perma.cc/E6X8-SXYH] (citing to an emerging financial relationship in which the third-party funder is playing a more active role in the case).

[339] ABA 20/20 REPORT, *supra* note 7, at 5–6. Recourse funding requires the funded party to pay the funder for the cost of money, regardless of whether the party prevails. *See id.* at

typology of a third-party funder; consequently, each third-party funding agreement differs in purpose, form and context.[340] Even the name "third-party funder" may in many cases be a misnomer, because the funder, depending on the terms of the contract, is often not an actual party to the litigation.[341] Therefore, disclosure about the presence of funders and their contractual relationship with the litigant is relevant to dispute resolution providers and professionals who will be facilitating the settlement of the case.[342]

II. GLOBAL EXPERIENCE SHAPES ETHICAL RULES AND GUIDELINES

Our global brethren have embraced third-party funding as an economic necessity to fund the escalating costs of litigation and international dispute resolution.[343] Along with such cumulative experience with third-party funders, however, comes a heightened awareness about the potential ethical minefields that may occur when third-party funders participate. This heightened awareness has served as the global impetus to promulgate ethical rules and develop best practices for dispute resolution providers and neutrals that require greater transparency of third-party funders.[344] The global community recognizes that without these defined boundaries, third-party funders, untethered by rules or regulations,[345]

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6. Nonrecourse funding requires the funded party to pay the funder only if the funded party prevails. *Id.* at 7.

[340] *See* Sahani, *supra* note 11, at 411–12; ICCA REPORT, *supra* note 9, at 47–48.

[341] This author met with Alan Zimmerman, CEO and Legal Counsel of Law Finance Group, a funding provider, on June 19, 2017. During our conversation, Mr. Zimmerman noted how the term "third-party funder" is not an accurate label, because funders are not a party to the litigation.

[342] *See infra* Part IV.

[343] *See Third Party Funding in International Arbitration*, ASHURST (Sept. 4, 2018),

https://www.ashurst.com/en/news-and-insights/legal-updates/quickguide---third-party-funding-in-international-arbitration/ [https://perma.cc/DS2P-DNV4] (discussing the approaches to the legality of third-party funding taken by various jurisdictions, including those that embrace it, such as Hong Kong and Singapore, and those that have rejected it, such as Ireland); *see also* ICCA REPORT, *supra* note 9, at 17; Arbitration and Mediation Legislation (Third Party Funding) (Amendment), No. 6, (2017) Cap. 609, A137, § 98 (H.K.).

[344] *See* sources cited *supra* note 36.

[345] *See, e.g.*, THE ASSOCIATION OF LITIGATION FUNDERS OF ENGLAND AND WALES, CODE OF CONDUCT FOR LITIGATION FUNDERS (Nov. 2011), https://www.judiciary.uk/wp-content/uploads/JCO/Documents/CJC/Publications/CJC+papers/Code+of+Conduct+for+Li

will continue to ethically collide with lawyers, dispute resolution providers and neutrals, whose professional behaviors are defined by their respective ethical rules of conduct.[346] In order for mediators and arbitrators to follow-through on their ethical mandates about disclosure of conflicts of interest and impartiality, they must first be made aware that a third-party funder with whom they have had previous commercial transactions is now funding a participant in the current matter.[347]

This section highlights two global initiatives that are shaping the participatory boundaries of third-party funders in dispute resolution: the passage of Hong Kong's Bill 2016, Arbitration and Mediation Legislation,[348] and the ICCA-Queen Mary College of the University of London Task Force.[349] Although each initiative has different purposes, both share common threads. Both recognize that there needs to be disclosure about third-party funders in arbitration and mediation, and that failure to have disclosure will perpetuate ethical violations of dispute resolution tenets. Both recognize third-party funder is an umbrella term that describes many permeations of economic support, some legal and others of questionable integrity. And both initiatives call for greater oversight of third-party funders.

A. HONG KONG'S BILL 2016, ARBITRATION AND MEDIATION LEGISLATION

The passage of Hong Kong's Bill 2016, Arbitration and Mediation Legislation (Third-Party Funding) ("HK Bill 2016") on June 14, 2017, is the first global legislation that affirms the legitimacy of third-party funding in international dispute resolution.[350] This legislation synchronizes Hong Kong's Law on third-

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tigation+Funders+(November+2011).pdf [https://perma.cc/7LVC-TQF2] (providing guidelines for funders about adequacy of funds and accuracy of promotional literature, including the requirement that litigation funding agreements ("LFAs") should include the litigation funder's role in settling the case and withdrawing from the funding agreement).

346.CATHERINE A. ROGERS, *Gamblers, Loan Sharks, and Third-Party Funders, in* ETHICS IN INTERNATIONAL ARBITRATION 177, 182 (2014).

[347]. *See* Sahani, *supra* note 27, at 401–02.

348.*See* Cap. 609, A137, § 98.

349.ICCA REPORT, *supra* note 9.

350.*See Bills Committee on Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Bill 2016,* LEGIS. COUNCIL H.K. SPECIAL ADMIN. REGION CHINA, https://www.legco.gov.hk/yr16-17/english/bc/bc102/general/bc102.htm party funding in international dispute resolution with the practices of China's International Dispute Resolution providers by reaffirming that the common law offenses of maintenance and champerty do not apply to third-party funding in international dispute resolution.[351] Significantly, HK Bill 2016 applies not only to the conduct of third-party funders in international arbitration, but also in international mediation.[352] The HK Bill 2016 provides in its salient parts directives regarding the regulation and disclosure of third-party funders participating in arbitration and mediation.

The law requires that a Code of Practice be developed that provides "practices and standards" for third-party funders to follow.[353] The Code of Practice is currently in development by the HK government.[354] A third-party funded agreement must be in writing,[355] and must also explicitly state the risk and terms and include:

> (i)the degree of control that third party funders will have in relation to an arbitration [or mediation];
>
> (ii)whether, and to what extent, third party funders (or persons associated with the third party funders) will be liable to funded parties for adverse costs, insurance premiums, security for costs and other financial liabilities; and
>
> (iii) when, and on what basis, parties to funding agreements may terminate the funding agreements or third party funders may withhold arbitration funding.[356]

HK Bill 2016 also provides additional mandates that should be included in the Code of Practice for third-party funders to ensure ethical practice. For example,

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[https://perma.cc/B6K5-BJUT]. *See also* Cap. 609, A137, § 98E(a). It is important to emphasize that this applies only to domestic arbitration. Third-party funding is still prohibited in Hong Kong domestic litigation.

[351] Cap. 609, A137, § 98K; *see also Third-Party Funding in International Arbitration*, *supra* note 36.

[352] Cap. 609, A137, § 98F.

[353] *Id.* § 98P.

[354] Joseph Chung, *Draft Code of Practice for Third Party Funding of Arbitration and Mediation*, DEACONS (Oct. 26, 2018), https://www.deacons.com.hk/news-and-insights/publications/draft-code-of-practice-for-third-party-funding-of-arbitration-and-mediation.html [https://perma.cc/KY7X-FF7G].

[355] Cap. 609, A137, § 98H.

[356] *Id.* § 98Q(1)(b).

prior to a party entering into a third-party funding agreement, third-party funders should advise potential funded parties to consult with independent legal counselors before entering into the third-party funding agreement.[357] Third-party funders are required to have a "sufficient minimum amount of capital."[358] Moreover, third-party funders are required to have in place procedures to respond to "potential, actual or perceived conflicts of interest,"[359] and when complaints do arise, "effective procedures" and "meaningful remedies" to address those complaints.[360]

In large part, Hong Kong enacted this groundbreaking legislation to reinforce Hong Kong's stature as a leading center for international dispute resolution in the Asia-Pacific region.[361] The impact of this legislation is not limited to China, but rather establishes regulation and disclosure standards concerning third-party funders that can help shape the ethical contours of third-party funding in global dispute resolution.[362]

B. ICCA REPORT ADDRESSES THE ETHICAL ISSUES PRESENTED BY THIRD-PARTY FUNDERS IN INTERNATIONAL ARBITRATION

In 2013, the International Council for Commercial Arbitration ("ICCA") in collaboration with the Queen Mary College of the University of London formed a Task Force to provide "greater understanding about what third-party funding is and . . . the issues it raises in international arbitration."[363] In large part, the Task

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[357] *Id.* § 98Q(1)(c).

[358] *Id.* § 98Q(1)(e).

[359] *Id.* § 98Q(1)(f).

[360] *Id.* § 98Q(1)(g).

[361] LEGIS. COUNCIL, REPORT OF THE BILLS COMMITTEE ON ARBITRATION AND MEDIATION LEGISLATION (THIRD PATY FUNDING) (AMENDMENT), No. CB(4)1161/16-17, ¶ 8 (2016) (H.K.).

[362] *See* Singapore Civil Law Act (Chapter 43) Civil Law (Third-Party Funding) Regulations 2017, c. 43, § 68. The Singapore Law followed on the heels of the Hong Kong Law, as each center tried to gain control of the international arbitration and mediation market. It is important to note that Singapore, like Hong Kong, does not permit third-party funding in domestic Singaporean courts. *See Third Party Funding of Arbitration in Singapore and Hong Kong: A Comparison*, ASHURST (Feb. 13, 2017), https://www.ashurst.com/en/news-and-insights/legal-updates/third-party-funding-of-arbitration-in-singapore-and-hong-kong-a-comparison/ [https://perma.cc/XQC3-UG7W].

[363] ICCA REPORT, *supra* note 9, at 3; *see also id.* at 7 (describing the scope of the Task Force's work to include "analysis of specific issues that directly affect international

Force came together to address the reality that litigation funders were investing in international arbitration because such arbitrations were of high value and offered little opportunity for appeal.[364] Furthermore, there was concern that funders are able to structure their funding agreements by choosing choices of law and forums to avoid scrutiny of their investing practices.[365] In April 2018, the Task Force issued a Report on its findings.[366]

In order to accommodate "the range of existing third-party funding models" and anticipate new developments, the Report adopted a broad working definition of third-party funders and funding.[367]

The Report defines "third-party funding" as:

> [A]n agreement by an entity that is not a party to the dispute to provide a party, an affiliate of that party or a law firm representing that party,
>
> a) funds or other material support in order to finance part or all of the cost of the proceedings, either individually or as part of a specific range of cases, and
>
> b) such support or financing is either provided in exchange for remuneration or reimbursement that is wholly or partially dependent on the outcome of the dispute, or provided through a grant or in return for a premium payment.[368]

It goes on to define a third-party funder as:

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arbitration proceedings and are capable of being addressed at an international level (i.e., conflicts of interest, privilege, and costs and security for costs)").

[364] *See, e.g.*, *id.* at 4 ("Since the Task Force was initially constituted in 2013 . . . . The funding market has expanded in several respects. The number of funded cases has increased significantly. The number and geographic diversity of third-party funders has also increased, with new entities continuing to enter the market and consequently increase the aggregate amounts available for funding."); *see also id.* at 25–27 (discussing the economics and return structures of third-party funding).

[365] *See* Rebecca Mulder & Marc Krestin, *Third-Party Funding in International Arbitration: To Regulate or Not to Regulate?*, YOUNG ICCA BLOG (Dec. 18, 2017), http://www.youngicca-blog.com/third-party-funding-in-international-arbitration-to-regulate-or-not-to-regulate/ [https://perma.cc/XW7A-73YJ].

[366]. ICCA REPORT, *supra* note 9, at i.

[367]. *Id.* at 50.

[368] *Id.* See also *id.* at 56–70 for a survey of existing definitions.

> [A]ny natural or legal person who is not a party to the dispute but who enters into an agreement either with a party, an affiliate of that party, or a law firm representing that party:
>
> a) in order to provide material support for or to finance part or all of the cost of the proceedings, either individually or as part of a specific range of cases, and
>
> b) such support or financing is either provided in exchange for remuneration or reimbursement that is wholly or partially dependent on the outcome of the dispute, or provided through a grant or in return for a premium payment.[369]

In addition to the working definitions, the Task Force addressed four ethical issues that are raised when third-party funders provide support in international arbitration: (1) the potential conflicts of interest between the arbitrator and third-party funder; (2) how sharing information with a third-party funder might affect the attorney-client privilege; (3) whether there is a need for third-party funding to provide security for costs; and (4) how the presence of a third-party funder affects the allocation of costs.[370]

1. Conflicts of Interest Between the Arbitrator and Third-Party Funder[371]

The Report recognizes that the international arbitration community has become an insular club in which third-party funders, attorneys and arbitrators have ongoing contact.[372] Contributing to this insularity, attorneys on one case may switch hats and serve as an arbitrator on another case.[373] Adding to this insularity, third-party funders are increasingly tapping experienced attorney from this pool to work for the funders and serve on their advisory boards.[374] Despite some disagreement, the Report proposed "systematic disclosure" because "disclosure by the funded party of the existence and identity of funders is necessary so that

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369.*Id.* at 50.

[370]. *Id.* at 12.

371.*Id.* at 63, 81–115 (discussing the revision of the International Bar Association (IBA) Guidelines on Conflicts of Interest).

372.*See id.* at 82.

373.*See* Jennifer A. Trusz, *Full Disclosure? Conflicts of Interest Arising from Third-Party Funding in International Commercial Arbitration*, 101 GEO. L.J. 1649, 1669–71 (2013).

374.ICCA REPORT, *supra* note 9, at 82.

arbitrators [can] make appropriate disclosures and decisions regarding potential conflicts of interest."[375] Accordingly, the Report calls for parties to "disclose the existence of a third-party funding arrangement and the identity of the funder to the arbitrator . . . as part of a first appearance . . . or as soon as practicable."[376] This proposal is "in keeping with global trends in regulation of third-party funding," consistent with an ICCA survey that found broad support for disclosure of third-party funding arrangements and funders,[377] and recognizes the many potential conflicts between arbitrators and funders that could arise in several circumstances.[378] Colleagues in the arbitrator's law firm might be working with the third-party funder on another matter.[379] In another example, the arbitrator could be the arbitrator on a case funded by the third-party funder, and then counsel on another case funded by the same third-party funder.[380] Without disclosure of these conflicts, the arbitrator's impartiality and commitment to maintaining an international arbitration of integrity would be called into question.[381]

2. Confidentiality and Attorney Client-Privilege[382]

Prior to deciding to fund a case, third-party funders gather information from the attorney and client to assess the viability of funding that case.[383] Is the sharing of that information done so in a way that waives the attorney-client privilege or is it done so in a way that protects the attorney-client privilege? As the Report notes, "[t]he rise of third-party funding has added new complexities to existing ambiguities about privilege in international arbitration."[384] The Report identifies three categories of information that implicate these complexities.[385] The first category is privileged information that is provided to a third-party at the "initial

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375.*Id.* at 83.

[376]. *Id.* at 81.

[377]. *Id.* at 83.

378.*Id.* at 82.

379.*See id.* at 111.

380.*Id.* at 112.

381.*See id.* at 87.

382.*Id.* at 117.

383.*See id.*

384.*Id.* at 118.

385.*Id.* at 118–19.

due diligence phase"[386] and after it has committed to funding the party.[387] The second category involves the funding agreement itself.[388] The final category includes documents produced and held by the funder, such as the funder's assessment of the case, "documents relating to the negotiation of the funding agreement," and legal opinions on the strength of the case generated by the funder.[389]

The Report takes the position that the "existence of funding and the identity of a third-party funder is not subject to any legal privilege."[390] The specific provisions of a funding agreement, on the other hand, "may be subject to confidentiality obligations . . . and may include information that is subject to a legal privilege."[391] Production of these specific provisions should be ordered by the arbitral tribunal only "in exceptional circumstances."[392] Finally, on the question of waiver, the Report states that the mere fact that privileged information is furnished to a third-party funder should not waive the privilege, so long as the information was provided "for the purpose of obtaining funding or supporting the funding relationship."[393]

3. Allocation of Costs and Security of Costs[394]

The Report also examined how to respond to security of cost applications at the beginning of the arbitration and applications for allocation of costs at the end of the arbitration when one or both parties are funded by a third-party funder.[395]

As mentioned in the introduction of this article, the global legal regimes are different than the U.S. legal system. One glaring difference is that the English rule requires the losing party in litigation to pay the winner's attorney's fees, while

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[386] *Id*. at 118. The Report describes that phase as "where funding is first requested and the third-party funder requires information in order to decide whether or not to provide financing." *Id*.

[387] *Id*. at 119.

[388] *Id*.

[389] *Id*.

[390] *Id*. at 117.

[391] *Id*.

[392] *Id*.

[393] *Id*.

[394] *Id*. at 146.

[395] *Id*.

the American rule followed in the United States requires each party to be responsible for its respective legal fees.[396] In arbitration, however, arbitrators may award costs in a different proportion than the "all or nothing" English rule would suggest.[397] In another departure from the distinction between the American and English rule, the Federal Arbitration Act provides that U.S. domestic arbitrators may enforce international arbitration awards that allocate costs in a manner different than the American rule.[398] Thus, some of the advances cannot be transported wholesale because of these differences.

However, these initiatives can also generate ideas about what should be included in U.S. ethical guidelines for dispute resolution providers and neutrals. Alternative Dispute Resolution ("ADR") providers and neutrals should consider requiring disclosure of third-party funding of a party participating in arbitration and mediation. Another consideration is what information can be shared with the other party because the attorney-client privilege has been waived and what information remains privileged. In another example, the awarding of third-party funding costs as part of the arbitration award may be one global practice that may be transported to the United States and have ethical ramifications.[399]

III. IN THE UNITED STATES, A SLOWER PULSE

In contrast to the welcome global embrace for third-party funders, the United States has maintained an ambivalent and cautious approach towards third-party funding. Domestically, U.S. courts have divided on the legality of third-party

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[396]. Theodore Eisenberg & Geoffrey P. Miller, *The English Versus the American Rule on Attorney Fees: An Empirical Study of Public Company Contracts*, 98 CORNELL L. REV. 327, 327 (2013).

[397]. *See Counting the Costs of Arbitration*, BIRD & BIRD (Dec. 2005), https://www.twobirds.com/en/news/articles/2005/counting-the-cost-of-arbitration [https://perma.cc/7YYP-PWEG].

398.*See* 9 U.S.C. § 207 (2018).

399.*See* John Fellas, *Can Arbitrators Award Third-Party Funding Costs in International Arbitration?*, N.Y. L.J. (June 30, 2017), https://advance.lexis.com/api/permalink/4b4d371e-8751-4f20-8d3a-331c417074e4/?context=1000516 [https://perma.cc/ST4Q-TZ3T] (explaining how cost-shifting, in which the arbitrator orders the losing party to pay the costs of the prevailing party, is part of international arbitration. Litigation funding is now an included part of those costs. Mr. Fellas posits that the Federal Arbitration Act could also be interpreted to mean that costs include the cost of litigation funders.).

funders.[400] Some courts have abandoned barratry, champerty and maintenance, while other courts still rely on these prohibitions to help define permissible outsider conduct.[401] To this day, courts still frown upon those outsiders to litigation such as third-party funders who instigate, control, fund, and profit from litigation to which they are not a party.[402] The litigant-judge relationship remains sacrosanct.[403] One reason proffered for the U.S.'s hesitance about third-party funding is a long-held value that one shouldn't profit from another's harm.[404] This section will provide a snapshot of the U.S.'s reaction by highlighting three spheres of influence that are shaping the U.S.'s response to third-party funding: the courts, the American Bar Association, and public interest groups such as the Rand Institute and the U.S. Chamber Institute for Legal Reform.

A. SURVEY OF COURT RESPONSES

The U.S. courts have had a range of responses to third-party funders from acceptance,[405] conditional acceptance,[406] to outright rejection of the concept.[407] *Miller UK Ltd. v. Caterpillar, Inc.*[408] is an instructive case that highlights the layers of confidentiality issues raised by the presence of third-party funders. As a threshold issue, the court found that litigation funding is legal in Illinois, because the doctrines of maintenance and champerty "have been narrowed to a filament."[409] Moreover, the purpose of the funding in the case at bar was not "to promote strife or contention," but to provide needed economic backing to advance the party's claim.[410]

Instructive to our discussion, the court explained analogizing third-party funding to insurance is an inaccurate comparison because litigation funding and

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400.*See* ABA 20/20 REPORT, *supra* note 7, at 9–12; MCGOVERN ET AL., *supra* note 3, at 11–12, 129 (discussing contemporary U.S. domestic court responses to third-party funding).

[401]. *See* ABA 20/20 REPORT, *supra* note 7, at 11–12.

402.MCGOVERN ET AL., *supra* note 3, at 23.

403.*See id.* at 10–11.

404.*Id.* at 23.

405.*See* ABA 20/20 REPORT, *supra* note 7, at 9–12.

406.*See* Justinian Capital SPC v. WestLB AG, 65 N.E.3d 1253, 1256 (N.Y. 2016).

[407]. *See, e.g.*, Johnson v. Wright, 682 N.W.2d 671, 677–78 (Minn. Ct. App. 2004).

408.17 F. Supp. 3d 711 (N.D. Ill. 2014).

409.*Id.* at 727.

410.*Id.* at 726.

insurance each create distinct financial relationships: "Abraham Lincoln once was asked how many legs a donkey has if you call its tail a leg. His answer was four: calling a tail a leg does not make it one."[411] With insurance, the relationship between insurer and insured is one of indemnification. The insurance company, as the subrogee, is "limited to reimbursement for what it paid its insured and no more."[412] In contradistinction, the relationship between a litigation funder and the party it funds is limited by the amount of funds the litigation funder has agreed to loan the fundee. The funder is not a subrogee and will not pay for the fundee's losses or indemnify the funder.[413]

The court also addressed whether privileged attorney-client information shared with a third-party funder waived that confidentiality privilege or remained privileged because the third-party funder shared a "common interest in the successful outcome of the litigation."[414] The court opined the sharing of information with litigation funders was not protected by the common interest doctrine, because the relationship was about money, not legal strategies or opinions.[415] However, the court found that even though the information shared with the third-party funder was not protected by the "common interest" doctrine, it was protected by the confidentiality agreement that was signed by the funder prior to receiving the privileged information.[416]

B. ABA COMMISSION ON ETHICS 20/20

The American Bar Association Commission on Ethics 20/20 Information Report to the House of Delegates (the "ABA 20/20 Report") focuses on how the third-party funders might ethically compromise the attorney-client relationship.[417] The Commission cautioned about potential ethical threats to lawyers' professional responsibilities in three areas. First, the lawyer should ensure that any third-party funding agreement or relationship does not compromise or disincentivize the lawyer's independent professional judgment in the attorney-client

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[411] *Id.* at 729.

[412] *Id.*

[413] *Id.*

[414] *Id.* at 731–35.

[415] *Id.* at 732–34.

[416] *See id.* at 736–39.

[417] ABA 20/20 REPORT, *supra* note 7, at 15–29.

relationship.[418] Thus, lawyers should avoid third-party funding agreements that attempt to overtake control of the case.[419] Second, the lawyer should take care that when the client or lawyer share privileged information protected by the attorney-client privilege with the third-party funder, the lawyer should take steps to protect that confidentiality.[420] Third, the lawyer should have an adequate understanding of how third-party funders work so that the lawyer may inform and counsel the client about any potential risks associated working with funders.[421]

Of particular interest to dispute resolution neutrals, the Commission raised that a contractual obligation with a third-party funder might influence a party's decision-making process regarding settlement.[422] Some agreements with third-party funders explicitly state that the funder has to approve the settlement.[423] Yet, even if the contractual agreement is silent on this point, the funded party may "implicitly" consider the funded amount in assessing whether the settlement number is adequate.[424]

The Commission recognized that because there are so many variations of third-party funding agreements, it is challenging to identify all the possible ethical issues for lawyers that may arise from these different permeations.[425] Moreover, as third-party funders continue to evolve and offer different types of financial support, new ethical challenges could emerge.[426] The Commission reinforced that the client, as a matter of agency law, has a right to delegate revocable settlement authority to other agents such as a third-party funder.[427] However, any agreement with a third-party funder should not interfere with a client's option of terminating the lawyer-client relationship at any time.[428]

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[418] *Id*. at 22.
[419] *Id*. at 21.
[420] *Id*. at 30.
[421] *Id*. at 38.
[422] *Id*. at 27.
[423] *Id*.
[424] *Id*. at 28.
[425] *Id*.
[426] *Id*. at 5.
[427] *Id*. at 27.
[428] *Id*. at 16.

C. PUBLIC INTEREST RESEARCH

1. The Rand Report—Third Party Litigation Funding[429]

In 2009, the UCLA-RAND Center for Law and Policy convened *Third-Party Litigation Funding and Claim Transfer: Trends and Implications for the Civil Justice System* (the "Rand Report"), the first U.S. symposium on third-party funding.[430] Bringing together representatives from the business, legal, academic, and not-for-profit communities, the group investigated how third-party funding will impact the civil justice system.[431] The group did not anticipate that third-party funders would provoke a rise in frivolous cases.[432] Rather, the group concluded that more research was needed on whether third-party funders could use risk analysis to identify and support more meritorious cases.[433] The group discussed the ethical concerns raised by third-party funders such as the confidentiality issues in the lawyer-client relationship.[434] Participants expressed that there exists sufficient elasticity in the existing ethical rules to accommodate these ethical concerns.[435]

In a noteworthy follow-up to the 2009 Rand Report, Steven Garber examined the economic, legal, and ethical issues related to third-party financing in the United States,[436] in particular its possible effects on the likelihood and timing of settlements.[437] First, Garber recognizes that disclosure of the mere existence of third-party funding may make the defendant more inclined to settle.[438] This is because "a defendant who knows that the plaintiff has [funding] may infer from

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[429] The Rand Corporation is a non-profit research organization which "is dedicated to making the civil justice system more efficient and more equitable." *Rand Institute for Civil Justice*, RAND CORP., https://www.rand.org/jie/justice-policy/civil-justice.html [http://perma.cc/4YPC-QL87] (last visited Feb. 22, 2019).

[430] MCGOVERN ET AL., *supra* note 3, at 1.

[431] *Id.* at iii.

[432] *Id.* at 20.

[433] *Id.*

[434] *Id.* at 16.

[435] *Id.* at 17.

[436] *See generally* STEVEN GARBER, RAND CORP., ALTERNATIVE LITIGATION FINANCING IN THE UNITED STATES (2010), https://www.rand.org/content/dam/rand/pubs/occasional_papers/2010/RAND_OP306.pdf [https://perma.cc/VK5V-BJEX].

[437] *Id.* at 32.

[438] *Id.*

the existence of [such funding] that the legal claim has legal merit or high economic value . . . ."[439] Second, Garber reasons that "the existence of a non-recourse loan to a plaintiff could impede settlements both early and late in the life of the underlying lawsuit, but promote settlements during a period of time in between."[440]

2. The U.S. Chamber Institute for Legal Reform[441]

The U.S. Chamber Institute for Legal Reform, a non-profit affiliate of the U.S. Chamber of Commerce and an advocacy group to promote civil justice reform, has taken on the issue of third-party funding.[442] Unlike the Rand Report, which offers a cautiously accepting approach to third-party funding, the U.S. Chamber Institute for Legal Reform has been banging the drums and warning that "the sky is falling" unless our legal system takes affirmative steps to protect against the "parade of horribles" that third-party funders may cause.[443] The Chamber warns that unchecked, third-party funders will promote frivolous litigation.[444] In a passionate letter joined by over two dozen other business organizations, the Chamber has also called for a revision of the Federal Rules of Civil Procedure to require that parties disclose in all civil cases when they receive backing from third-party funders.[445]

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[439] Garber notes that this scenario is most plausible in the context of investments in commercial claims, however, because third-party funders in this context have rigorous claim-assessment procedures. *Id.* at 33.

[440] *Id.*

[441] JOHN BEISNER ET AL., U.S. CHAMBER INST. FOR LEGAL REFORM, SELLING LAWSUITS, BUYING TROUBLE: THIRD-PARTY LITIGATION FUNDING IN THE UNITED STATES (Oct. 2009), http://www.instituteforlegalreform.com/uploads/sites/1/thirdpartylitigationfinancing.pdf [https://perma.cc/7WUH-P4KZ].

[442] *About ILR*, U.S. CHAMBER INST. FOR LEGAL REFORM, https://www.instituteforlegalreform.com/about-ilr [https://perma.cc/9YQN-2J2C] (last visited Feb. 24, 2018).

[443] *See* BEISNER ET AL., *supra* note 134, at 4–5.

[444] *Id.* at 5–7.

[445] The Committee on Rules of Practice and Procedure has considered such a proposed amendment, once in 2014 and again in 2016. Memorandum from Hon. John D. Bates, Chair, Advisory Comm. on Civil Rules, to Hon. David G. Campbell, Chair, Comm. on Rules of Practice and Procedure (Dec. 6, 2017), *in* ADVISORY COMM. ON CIVIL RULES, AGENDA BOOK 235, 247–51, https://www.uscourts.gov/sites/default/files/2018-01-standing-agenda-book.pdf [https://perma.cc/Z5TJ-VMHF]. On both occasions, the committee concluded that the topic was not "ripe." *Id.* at 247.

Although the Civil Rules Committee has yet to revise the Federal Rules of Civil Procedure, the concerns raised by the U.S. Chamber Institute for Legal Reform have been heeded. On January 17, 2017, the U.S. District Court for the Northern District of California required that parties in class actions must disclose whether they are receiving funding.[446] In an even bolder action, on April 3, 2018, Wisconsin enacted Wisconsin Act 235,[447] becoming the first state to require litigants in civil actions to disclose their litigation funding agreements whether or not they are asked to do so.[448] Then on April 10, 2018, the Civil Rules Committee issued a 50-state survey regarding third party-funding disclosure.[449]

Thus, even though the United States retains a cautionary approach to third-party funders, some states are recognizing the importance of disclosure and are beginning to enact statutes and court rules compelling disclosure.[450] The U.S. courts, however, have yet to reach consensus on the legality of third-party funders. The not-for-profits groups who have researched how litigation funders might impact litigation have focused their efforts on amplifying their concerns about how third-party funding could potentially erode the fabric of our justice system. However, while these well-intentioned organizations continue to pontificate about their concerns regarding third-party funders, the funders continue to participate in such dispute resolution processes as mediation and arbitration, invisible and unregulated. The next Part incorporates the expressed concern and

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[446] *See* Standing Order for All Judges of the Northern District of California, Contents of Joint Case Management Statement ¶ 19 (Nov. 1, 2018), https://cand.uscourts.gov/whaorders [https://perma.cc/Q9EL-4KJF]; Memorandum from Patrick A. Tighe, *supra* note 1, at 211.

[447] WIS. STAT. § 804.01(2)(bg) (2018).

[448] Expectedly, supporters of disclosure applauded this legislation while litigation funders voiced concerns that this legislation did not distinguish between disclosure requirements for consumer and commercial cases. Jamie Hwang, *Wisconsin Law Requires All Litigation Funding Arrangements to Be Disclosed*, A.B.A. J.: DAILY NEWS (Apr. 10, 2018, 10:45 AM), http://www.abajournal.com/news/article/wisconsin_law_requires_all_litigation_funding_arrangements_to_be_disclosed/[https://perma.cc/3DMY-29XY]. While third-party funders have accepted disclosure as part of international practice, third-party funders continue to push back about efforts to require disclosure in the U.S. *See, e.g.*, *Mandatory Disclosure of Funders Would Further Clog Overburdened Court Dockets*, BENTHAM IMF (June 13, 2018), https://www.benthamimf.com/blog/blog-full-post/bentham-imf-blog/2018/06/13/mandatory-disclosure-of-funders-would-further-clog-overburdened-court-dockets [https://perma.cc/G8PV-ULCT].

[449] Tighe, *supra* note 1, at 209–29.

[450] *See id.*

advances the discussion by suggesting affirmative steps that should be taken by dispute resolution providers and neutrals to address the ethical concerns presented by third-party funders' participation in dispute resolution.

IV. PROPOSED ETHICAL GUIDELINES AND BEST PRACTICES FOR U.S. DISPUTE RESOLUTION PROVIDERS, ARBITRATORS, AND MEDIATORS

In this Part, I offer ethical guidelines and best practice suggestions for ADR providers,[451] arbitrators, and mediators so that the dispute resolution profession may more responsively address the real and apparent ethical issues that arise when a third-party funder backs a party who is participating in a dispute resolution procedure.[452] The time has come for dispute resolution providers and neutrals to acknowledge the reality of third-party funding, take affirmative steps to maintain the integrity of dispute resolution practices, and consider the potential benefits third- party funders bring to settlement. Some observe and others ignore the reality that third-party funders are proliferating and backing participating parties in our arbitrations and mediations with greater frequency. This ignorance is untenable, for the presence of third-party funders that provide financial backing to dispute resolution parties may at times challenge the ethical obligations of dispute resolution providers and neutrals.

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[451] See generally CPR–GEORGETOWN COMM'N ON ETHICS AND STANDARDS OF PRACTICE IN ADR, PRINCIPLES FOR ADR PROVIDER ORGANIZATIONS (2002), https://www.cpradr.org/resource-center/protocols-guidelines/ethics-codes/principles-for-adr-provider-organizations/_res/id=Attachments/index=0/Principles-for-ADR-Provider-Organizations.pdf [https://perma.cc/958L-JSRT] for guidance on how ADR providers should provide quality information about the services they provide to avoid ethical issues that would impugn the integrity of the organization and the dispute resolution procedures it provides.

[452] In this section, ADR providers include the courts as well as private providers. Litigants may actually mediate or arbitrate their dispute in three different contexts. First, some litigants may decide on their own to mediate or arbitrate their dispute once their legal dispute arises. In those cases, the litigants may opt to select their own private arbitrators or mediators either through a private ADR provider (administered process) or on their own. Second, the court may strongly recommend that litigants mediate or arbitrate their dispute once a legal action is commenced. Third, litigants may be obligated to mediate or arbitrate a dispute pursuant to contract.

An overarching interest of dispute resolution providers, arbitrators, and mediators when parties are backed by third-party funders is to obtain adequate relevant information about third-party funders so that ADR professionals can ensure that the dispute resolution process and any resulting settlement are procedurally and substantively fair and just.[453] In order to address this overarching interest, I offer three suggestions. First, dispute resolution providers and neutrals should require titrated disclosure about the relationship between the third-party funder and the party. Second, neutrals must be educated about how to work with third-party funders when they are backing any of the participating parties. Third, dispute resolution intake procedures, promotional materials, contracting forms, and other required paperwork need to be modified to gather relevant information about the third-party funder. I first explain these general suggestions and then tailor the application of each of these suggestions to the three different groups.

A. PROPOSAL ONE: TITRATED AND SEQUENTIAL DISCLOSURE ABOUT THE RELATIONSHIP BETWEEN THE THIRD-PARTY FUNDER AND PARTY

Disclosure remains a hotly contested and nuanced issue in which third-party funders tenaciously advocate for confidentiality of their contracting relationship with the party while those purveyors of justice, many untrusting of third-party funders, are demanding disclosure so that there is total transparency. Disclosure is not an all or nothing proposition; rather, it is a nuanced term that embraces what is disclosed, to whom disclosure is made, whether the information disclosed remains confidential, and at what phase of the dispute resolution procedure the information is to be disclosed. Acknowledging the apprehensions raised by third-party funders about disclosure and the dispute resolution profession's need for quality disclosure about third-party funders, I recommend that disclosure should be sequentially titrated and tailored to the different phases of the dispute resolution procedures. The information that is required to be disclosed should be based on the informational needs warranted at different phases of the given dispute resolution procedure. Moreover, such sequential, titrated disclosure helps

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[453] The measures for fair and just are measured differently in arbitration and mediation. *See* Judith L. Maute, *Public Values and Private Justice: A Case for Mediator Accountability*, 4 GEO. J. LEGAL ETHICS 503, 504–05 (1991).

avoid broad disclosure about the third-party funder in those instances when parties are not going forward with the dispute resolution procedure, or the information is not necessary.

1. Three Levels of Sequential Disclosure During the Contracting Phase of Arbitration and the Pre-Mediation Phase

a. Recommended Disclosure Level One

In the initial contracting phase between a party and the dispute resolution provider, arbitrator or mediator, disclosure about third-party funders should be limited to whether or not there is a third-party funder, and if there is, the names of those in the funder's organization. The rationale for disclosing the identity of the third-party funder is to ferret out early on in the dispute resolution process any potential conflicts that may exist between the third-party funder and the neutral.[454]

If there is a conflict, an ancillary issue that needs to be addressed at this phase is whether the conflict between the third-party funder and the neutral is a waivable one that first needs to be disclosed to the other party or is deemed to be a conflict that is not waivable. If those involved want the opportunity to waive the conflict, the identity and relationship of the funder must also be shared with the other party involved in the matter. Identifying conflicts doesn't necessarily mean disqualification. Customarily, when there is a conflict, conflicts can be waived at the consent of the parties.[455] Dispute resolution providers and neutrals can incorporate this level of disclosure into the existing conflict procedures used.

Another option is for dispute resolution providers to institute a per se rule that conflicts between the neutral and third-party funders cannot be waived. In that case, the identity of the third-party funder does not have to be disclosed. Dispute resolution professionals and providers have to decide on the rule they will choose to incorporate as part of their practice, and then notify parties about this rule.

I offer a cautionary note about considering the second option and instituting a per se ban on waiving conflicts. While some dispute resolution communities are large and have many dispute resolution professionals from which to select a

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[454] *See* ICCA REPORT, *supra* note 9, at 87.

[455] *See id.* at 81–115.

neutral, some dispute resolution practice communities are insular and just have a finite number of neutrals. In those instances, it is common that arbitrations and mediations involve the same people, just wearing different hats. In those cases, neutrals and providers may want to consider the ramifications of making conflicts between neutrals and third-party funders conflicts that can't be waived.

b. Recommended Disclosure Level Two

Once conflicts between the third-party funder and neutral are addressed and it is decided that the parties wish to proceed with the dispute resolution procedure, an additional level of disclosure that clarifies the relationship between the third-party funder and participant needs to be made at the contracting phase. The importance of such disclosure is to allow the dispute resolution provider, arbitrator, and mediator to discern if the third-party funder is actually a party to the dispute resolution procedure. Of course, determining whether or not a funder is a party is controversial and is a label that third-party funders prefer to avoid.[456] However, our primary concern is to maintain the integrity of our dispute resolution procedures. Therefore, dispute resolution providers, arbitrators, and mediators must have knowledge of all the parties who are influencing and shaping the resolution of the dispute.

If the third-party funder is a party, then what is its level of participation in the dispute resolution procedure and the concomitant obligations that come with that participation? For example, if the third-party funder is funding a party in mediation, shouldn't that third-party funder also be required to sign a confidentiality agreement protecting the confidentiality of mediation communications? In another example, if a party is to proceed to agreement and the party's funding agreement shows that the third-party funder is actually now a party, should the third-party funder be required to participate in the arbitration?

i) Disclosure raises concomitant confidentiality issues if the third-party funder participates in mediation and arbitration.

An important sub-issue that should also be addressed when clarifying the relationship between the third-party funder and the party is clarifying which

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[456] NIEUWVELD & SAHANI, *supra* note 1, at 47–48 discusses whether third-party funding is characterized as a loan subjecting it to usury laws versus a loan.

information that the lawyer and party shared with the third-party funder remains confidential as part of the attorney-client privilege and which information was shared in a way that waives the privilege. Whether or not the information that is shared with a third-party funder is done so in a way that waives or protects the attorney-client privilege has procedural implications in mediation and procedural and evidentiary implications in arbitration.

When it is disclosed that a third-party funder is backing a mediation party, that relationship raises three issues about mediation confidentiality that dispute resolution professionals need to address to preserve the integrity of mediation. A threshold issue that dispute resolution professionals need to clarify is how the third-party funder should be characterized. This professional characterization is important, because depending on the characterization of the third-party funder, different confidentiality concerns have to be resolved. For example, if a third-party funder learns in the course of a mediation confidential information about the other party that could give the third-party funder a trading advantage, the third-party funder should be barred from trading on that information. The second issue to be addressed is whether the dispute resolution party will communicate with the funder about mediation communications, and because there is an expectation by all mediation participants that the mediation communications are to remain confidential, should the third-party funder be compelled to also sign a confidentiality agreement or should the confidentiality agreement be amended so that it allows the dispute resolution party to consult with the third-party funders as one of its experts? So in mediation, if the participating party has a contractual relationship with the third-party funder that requires sharing of information, consultation, and direction as the case progresses, then the mediator should also have the third-party funder sign a confidentiality agreement to protect mediation confidentiality.[457]

If the third-party funder happens to also be a hedge fund, extra mediation confidentiality protections are needed to protect mediation confidentiality and prevent insider training. We learn from bankruptcy mediations in which hedge funds participate that added ethical screens/walls are needed to secure the

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[457] See *id*. at 154, stating that Indiana, Nebraska and Vermont are states who have enacted legislation providing that the attorney-client privilege includes sharing privileged work product and communication with third-party litigation funders.

mediation communications.[458] Another wrinkle that dispute resolution professionals need to address is that hedge funds that are also third-party funders might learn confidential information in the mediation about the other party that the hedge fund uses to trade on.[459]

Unlike mediation, in arbitration, the arbitrator makes determinations and issues awards based on the evidence presented.[460] Therefore, it is important to ascertain whether information shared with the third-party funder is done so in a way that protects or waives the attorney-client privilege.

c. Recommended Disclosure Level Three

A third level of disclosure that may be necessary is the financial relationship between the third-party funder and the funded party. Although this information may be needed in both arbitration and mediation, the information is needed in each dispute resolution procedure for different reasons. In arbitration, the information may be needed either to assess the costs one party incurred to go forward with the arbitration or to ensure that the third-party funder has sufficient funds to follow-through on his funding obligations. The decision about when this disclosure should take place is context specific. For example, if the other party makes a motion at the beginning of the arbitration for a bond of sufficiency, then that information needs to be provided at the beginning of the arbitration process. However, if no such motion is made, then the request for such information might not be made until the end of the arbitration when the neutral needs to be informed about the actual costs, including the cost of third-party funding, that the party has incurred.[461]

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[458] *See* Charles Duhigg & Peter Lattman, *Judge Says Hedge Funds May Have Used Inside Information*, N.Y. TIMES: DEALBOOK (Sept. 14, 2011, 9:28 PM), https://dealbook.nytimes.com/2011/09/14/judge-says-hedge-funds-may-have-used-inside-information/ [https://perma.cc/UX9B-2UKV].

[459] *See GM Judge Aims to Prevent Insider Trading by Distressed Debt Funds,* REUTERS (July 15, 2013), https://www.reuters.com/article/idUS162810420130715 [https://perma.cc/DXM4-WYTJ].

[460] *Comparison Between Arbitration & Mediation*, FIN. INDUSTRY REG. AUTHORITY, https://www.finra.org/arbitration-and-mediation/comparison-between-arbitration-mediation [https://perma.cc/94Y3-R8EM] (last visited Mar. 3, 2019).

[461] *See* ICCA REPORT, *supra* note 9, at 146.

In mediation, the information might be helpful to assess each party's commitment to yield a just result or to better understand the economics of a party's decision or ambivalence about settlement. Here again, the timing of the disclosure will be based on when this informational need arises. As one illustration, if a party needs to reimburse a third-party funder the borrowed amount, interest on that amount and an exponential return on any amount recovered, the party may be reluctant to accept what appears to the mediator, a reasonable settlement. Only when the party discloses the financial obligations to the funder might a mediator better understand the impasse and be able work with the parties in a more realistic way.

d. Recommended Disclosure Level Four

A fourth level of disclosure is the sharing of the third-party funder's objective assessment of the case. Because of their ability to create a matrix of information about the merits of the case with admirable objectivity, third-party funders are often considered to be super lawyers. Like other experts that are often part of arbitration and mediation processes, funders can be invited to share their analysis of the case, to provide evidence in the arbitration or to help address impasses in mediation. To date, third-party funders have resisted sharing their analysis of a case, insisting that their method of assessing whether a case is investment worthy is proprietary, and not to be shared with others. Going forward, however, as the push for greater transparency on the part of third-party funders gains momentum, dispute resolution professionals will have to work with third-party funders, as they work with other experts, to have third-party funders share their case analysis without disclosing all their proprietary methods.

B. PROPOSAL TWO: TRAINING FOR ADR PROVIDERS, ARBITRATORS, AND MEDIATORS

Professional dispute resolution training programs should be expanded to include education about the additional skills neutrals need to work with those parties backed by third-party funders. As was mentioned in the introduction of this paper, many dispute resolution professionals and providers are unaware that parties are backed by third-party funders even though increasing numbers of parties are receiving dispute funding. Yet, as this article has explained, such unawareness is creating an ethical minefield that potentially undermines the integrity of dispute resolution. Thus, a specialized training module is needed to heighten a neutral's awareness about third-party funders and to provide neutrals with the requisite skills needed to maintain a dispute resolution process of integrity.

The contents of such an additional training module should include the ethical issues that neutrals need to address when parties are funded; how to modify intake and process procedures to ferret out the existence of third-party funders; how to implement titrated levels of disclosure; strategies to help neutrals manage their own cognitive biases about third-party funders; how to incorporate the third-party funder's assessment of the case into the process; and skills to manage parties' own biases about third-party funders.

At this time, those ADR providers and trainers who are ahead of the curve and wish to develop a responsive training for neutrals will find more questions raised than answers provided. The scholarship surrounding third-party funding, to date, has centered on the ethics of the practice and the question of disclosure. The specifics of how disclosure of third-party funders might actually influence the dynamics with the neutral and participants, however, remain an unexplored area. In Part V of this paper, I raise these emerging questions and posit the possible dynamic shifts that third-party funders might spark arbitration and mediation.

V. HOW MIGHT DISCLOSURE IMPACT THE DYNAMICS OF THE DISPUTE RESOLUTION PROCESS

Once one or both parties disclose that they are receiving dispute funding, any conflicts emerging from that disclosure are addressed, and the dispute resolution process proceeds, the disclosure itself could also potentially shape the decision-making process of the neutrals and parties involved. Although there is no specific research on point, cognitive psychologists provide us with insights about how arbitrators, mediators, and disputants might be influenced by the knowledge that a dispute is receiving third-party funding.[462] Biases about

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[462] *See generally* MAHZARIN R. BANAJI & ANTHONY G. GREENWALD, BLINDSPOT: HIDDEN BIASES OF GOOD PEOPLE (2013); Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, 185 SCI. 1124 (1974).

third-party funding, the amount of funding that a party is receiving, and the terms of the funding agreement may all influence the dynamics in both arbitration and mediation.

A. EXPLICIT AND IMPLICIT BIAS ABOUT THIRD-PARTY FUNDING

Even though arbitrators and mediators are ethically mandated to be impartial,[463] they are also human beings who may have pre-existing ideas about the ethics of third-party funding. These pre-existing ideas or biases may cause the neutral to be explicitly or implicitly biased for or against third-party funders.[464] As with many biases, such bias could be formed and reinforced by the self-selected media and publications that the neutral has been exposed to about third-party funders.[465] For example, if a neutral is following the U.S. Chamber Institute for Legal Reform's concerted efforts to disallow third-party funders from operating "in the shadows," the neutral might be leery of funders.[466] However, if a neutral is enthusiastically following the success of hedge funds who are funding litigation, then the neutral might view funders more favorably.

Such biases, whether explicit or implicit, favorable or unfavorable, might influence how neutrals deviate from their ethical mandate of impartiality. Depending on the bias of the neutral, the neutral might then interpret the fact that a party is funded as an indication that the case at hand has enough merit to warrant investment or just an indication that the party needed money. Depending on the bias of the neutral, the neutral may consider the fact that a party is funded either as an indication of the level of commitment of the parties to go forward with the case or a vengeful step to drag the case on unnecessarily.

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[463] *See, e.g.*, CPR–GEORGETOWN COMM'N ON ETHICS AND STANDARDS OF PRACTICE IN ADR, *supra* note 144, at 10 ("The ADR Provider Organization has an obligation to ensure that ADR processes provided under its auspices are fundamentally fair and conducted in an impartial manner.").

[464] Jean-Christophe Honlet, *Recent Decisions on Third-Party Funding in Investment Arbitration*, 30 ICSID REV.–FOREIGN INV. L.J. 699, 699–712 (2015) (citing a case in which arbitrator Dr. Gavin Griffith Q.C. was unsuccessfully challenged because of the negative views he expressed about third-party funders).

[465] BANAJI & GREENWALD, *supra* note 155, at 164; *see also* DAN ARIELY, PREDICTABLY IRRATIONAL: THE HIDDEN FORCES THAT SHAPE OUR DECISIONS 201–23 (Harper Perennial ed. 2010) (2008).

[466] *See* BEISNER ET AL., *supra* note 134.

Cognitive psychologists explain that our biases are more likely to emerge in ambiguous situations where there are fewer rules to follow.[467] Thus, even though mediators and arbitrators might both be influenced by their biases about third-party funders, mediators might be more likely to be influenced by such bias.[468] The structure of the mediation process is more flexible and has less defined procedures than the arbitration process. For example, mediation may be conducted in joint meetings, private caucuses, or a combination of the two. Although the mediation parties, not the mediator, have the ultimate decision-making power, the mediator, in his role as a neutral, has greater discretion than an arbitrator about how to engage with the parties and influence the contours of the agreement the parties will reach.

On a subtler level, the dollar amount of the funding agreement might also unconsciously influence both the arbitrator's and mediator's shaping of a fair and just resolution. Cognitive psychologists educate about the power of anchoring, the undue influence that an initial number is given in subsequent decision making.[469] Thus, allocations of costs in arbitration and an acceptable settlement number might be unduly influenced by the amount of funding one or both parties are receiving. Might an arbitrator be influenced in making an award by the fact that one party has received a significant amount of backing by a third-party funder? Alternatively, if a defendant received a significant amount of backing by a third-party funder, might the arbitrator have greater sympathies for that defendant if the arbitrator issues an award that orders the defendant to pay for damages and costs? In mediation, how might the amount of the funding arrangements of the participants shape the mediator's prodding of a reasonable settlement?

Another yet unexplored issue is how, from the party's perspective, a party receiving funding calculates settlement decisions.[470] In part, the answer to this

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[467] Tversky & Kahneman, *supra* note 155, at 1124.

[468] *See e.g.*, Gilat J. Bachar & Deborah R. Hensler, *Does Alternative Dispute Resolution Facilitate Prejudice and Bias? We Still Don't Know*, 70 SMU L. REV. 817, 821–22 (2017); *see also* Richard Delgado et al., *Fairness and Formality: Minimizing the Risk of Prejudice in Alternative Dispute Resolution*, 1985 WIS. L. REV. 1359, 1400–04; Trina Grillo, *The Mediation Alternative: Process Dangers for Women*, 100 YALE L.J. 1545, 1587–94 (1991).

[469] Tversky & Kahneman, *supra* note 155, at 1129.

[470] ROBERT H. MNOOKIM, SCOTT R. PEPPET & ANDREW S. TULUMELLO, BEYOND WINNING: NEGOTIATING TO CREATE VALUE IN DEAL DISPUTES 112–13, 117–18 (2000) (describing how transaction costs can either deter or expedite settlement).

is likely based on the type of funding agreement that exists between a party and the funder. If a party has a recourse funding agreement in which the party is obligated to repay the funder for the borrowed money plus interest, it is reasonable to assume that such a financial obligation would be a consideration in the party assessing what a reasonable settlement would be. Might a party receiving an apology as part of that settlement might then devalue that apology if the party also has to repay the funder the borrowed money? Possibly, if a party has a nonrecourse loan, and doesn't have to repay the funder unless the party is victorious, the party may feel more empowered to proceed to judgment unless the settlement offer is as high as the expected litigated value.

Of course, disputants may have their own biases about third-party funders. If the disputant believes that third-party funders only back cases of merit, the disputant may be more inclined to settle once the disputant learns that the other party is receiving dispute funding.[471] However, if a disputant believes third-party funders are unethical scammers, the disputant may become less likely to settle and more determined to pursue her claim to vindication once the disputant learns the opposing side is receiving dispute funding.

Although this is an uncharted area, these are issues that dispute resolution professionals should be considering as they more actively engage with participants and the third-party funders who back them. Of course, neutrals need to become self-aware of their biases about third-party funders, along with all their other biases, so that the bias does not adversely influence the dispute resolution process. Such heightened awareness extends beyond the initial disclosure to see if there is a conflict with the neutral. Such heightened awareness extends throughout the mediation and arbitration.

B. PROPOSAL THREE: MODIFICATION OF DISPUTE RESOLUTION FORMS AND PROCEDURES THAT ACKNOWLEDGE THE POSSIBILITY OF THIRD-PARTY FUNDERS

One way to change the status quo practice of "don't ask, don't tell" that has allowed dispute resolution professionals to be unaware of the existence of third-party funders is to modify dispute resolution forms and procedures to actually ask

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[471] *See* GARBER, *supra* note 129, at 32.

if there is a third-party funder involved in the case. Dispute resolution forms and procedures should be modified to reflect an awareness that third-party funders may be backing one of the parties. For example, ADR providers' promotional materials, published rules and procedures could provide that experts, including third-party funders, may have a role in the given dispute resolution procedure. As mentioned above, dispute resolution professionals may include such a query as a regular part of their intake and contracting procedures.

CONCLUSION

The invisible practice of third-party funding is becoming increasingly visible. The time has come for dispute resolution providers and neutrals to see what they have yet to see before:[472] Third-party funders are shaping the practice of civil dispute resolution. Whether you believe this is an economic reality needed to address the escalating costs of conflict resolution or an evil that will erode our justice system, the dispute resolution profession must take affirmative steps to address the real and apparent ethical collisions between third-party funders and neutrals. This paper proposes ethical guidelines and best practices that provide for modification of dispute resolution providers' intake procedures, titrated disclosure of third-party funders, and training of neutrals. The goal is to help respond to the conflict and confidentiality concerns raised when third-party funders provide support for a party in arbitration or mediation.

This paper also appreciates that we are in the dawn of awareness about third-party funders. As a profession, it is challenging to speculate about what we don't know, but we must try.[473] Going forward, we will benefit from empirical research that clarifies how third-party funding shapes parties' decision-making about settlement. And of course, the looming overarching question is how third-party funders will influence the delivery of justice. This paper invites dispute resolution providers and neutrals to rethink their current practices, adapt, and work to create practices and guidelines that protect the integrity of the dispute resolution profession and the justice it provides.

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472. *Mark* 4:9 (NAB) ("Whoever has ears to hear ought to hear.").

473. "Change is the law of life and those who look only in the past or present are certain to miss the future." John F. Kennedy, President of the U.S., Address in the Assembly Hall at the Paulskirche in Frankfurt (June 25, 1963).

Please Ask, Please Tell: Disclosing Third-Party Funding in Mediation

Elayne E. Greenberg[474]

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INTRODUCTION

This addendum re-ignites the discussion about third-party disclosure in dispute resolution that began in "Hey, Big Spender: Ethical Guidelines for Dispute Resolution Professionals when Parties Are Backed by Third-Party Funders,"[475] and advocates for mandatory third-party funding (hereinafter TPF) disclosure when funded commercial cases are mediated.

As increasing numbers of domestic TPF commercial cases opt for settlement in mediation, domestic Alternative Dispute Resolution (hereinafter ADR) providers have still failed to adopt policies or procedure that address TPF disclosure in mediation.[476] *Don't ask, don't tell.* Even though TPF disclosure is fast becoming a required part of global mediation practice,[477] the U.S. continues to ignore lessons from our global community about TPF disclosure in mediation. Instead, the U.S. is engaging in a polarizing debate about third party funding disclosure in litigation

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[475] Elayne E. Greenberg, *Hey, Big Spender: Ethical Guidelines for Dispute Resolution Professionals when Parties Are Backed by Third-Party Funders,* 51 ARIZ. ST. L.J. 131 (2019). In that article, Professor Greenberg endorses TPF disclosure for both arbitration and mediation. This addendum focuses on the distinct reasons for TPF disclosure in mediation. The focus of TPF disclosure in mediation should not be misinterpreted to exclude the need for TPF disclosure in arbitration.

[476] *See generally* JUD. ARB. & MEDIATION SERVS., https://www.jamsadr.com (last visited Nov. 25, 2019); INT'L INST. FOR CONFLICT PREVENTION & RESOL., https://www.cpradr.org (last visited Nov. 25, 2019); AM. ARB. ASS'N, https://www.adr.org (last visited Nov. 25, 2019).

[477] *See, e.g.*, Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Bill, (2016) Cap. 1331, 1, § 1 (H.K.); Civil Law Bill (No 38 of 2016) (Singapore); Drew York, *Could Litigation Funding Disclosure Be Coming to Texas?*, JDSUPRA: TILTING THE SCALES (Mar. 20, 2019), https://www.jdsupra.com/legalnews/could-litigation-funding-disclosure-be-79839/ (discussing global trend towards disclosure).

that has become politicized,[478] legislated,[479] and litigated.[480] The dizzying and detracting consequences of such polarization have eclipsed the exploration of appropriate TPF mediation disclosure and have paralyzed any affirmative steps to promote disclosure in mediation. Maintaining the status quo threatens the integrity of mediation and comes at an irretrievable cost to funded parties.[481]

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[478] *See, e.g.*, York, *supra* note 4 (discussing the status of TPF in Texas); Lisa Miller, *Perils of Third-Party Funding*, L.A. LAW., Mar. 2017, https://www.lacba.org/docs/default-source/lal-magazine/2017-test-articles/march2017testarticle.pdf (noting that the conversation about whether or not to have TPF disclosure in litigated courts in California was a hotly debated issue); John Freund, *Republican Senators Reintroduce Litigation Funding Disclosure Bill*, LITIG. FIN. J., (Feb. 15, 2019), https://litigationfinancejournal.com/republican-senators-reintroduce-litigation-funding-disclosure-bill *Compare* Brackett B. Denniston, III et. al., *Letter Re: Proposed Amendment to Fed. R. Civ. P. 26(a)(1)(A)*, INST. FOR LEGAL REFORM (Jan. 31, 2019), https://instituteforlegalreform.com/wp-content/uploads/media/TPLF_letter_1.31.19 .pdf (CEOS letter supporting disclosure), *with* Alison Frankel, *Litigation Funders Blast U.S. Chamber, GCs for Disclosure Push*, REUTERS (Feb. 25, 2019), https://www.reuters.com/article/ legal-us-otc-litfunding/litigation-funders-blast-u-s-chamber-gcs-for-disclosure-push-idUSKCN1QA2Z4 (arguing that this sentiment is disingenuous and merely a response to pressure to disclose).

[479] *See, e.g.*, WIS. STAT. § 804.01(2)(bg) (2017-18) (requires the disclosure); N.D. CAL. CIV. LOCAL R. 3-15 (requiring disclosure of non-party interested entities or persons). The enacted rule allowed for more limited discovery than what was initially proposed. *See* Ben Hancock, *Northern District, First in Nation, Mandates Disclosure of Third-Party Funding in Class Actions*, RECORDER (Jan. 23, 2017), https://www.law.com/therecorder/almID/1202777487488/ Northern-District-First-in-Nation-Mandates-Disclosure-of-ThirdParty-Funding-in-Class-Actions/

[480] *See, e.g.*, *In re* Valsartan N – Nitrosodimethylamine (NDMA) Contamination Prods. Liab. Litig., 405 F. Supp. 3d 612 (D.N.J. 2019) (denying defendant's broad discovery request of plaintiff's litigation funding agreements and documents, but allowing in-camera review of documents to assess if the litigation funder was controlling or advising the funded party); Space Data Corp. v. X, No. 16-cv-03260-BLF, 2017 U.S. Dist. LEXIS 22571 (N.D. Cal. Feb. 16, 2017) (defendants move to compel discovery of the board minutes in which the litigation funder was denied because the request was neither relevant or proportional) [Does this parenthetical match the citation? The cited source appears to be dealing with a motion to dismiss under 12(b)(6), not a motion to compel.]. The U.S. District Court for the Northern District of California denied as irrelevant defendant Micron Technology's demand that plaintiff MLC Intellectual Property disclose the identity of any third-party funder backing MLC's patent infringement lawsuit. MLC Intellectual Prop., LLC v. Micron Tech., Inc., No. 14-cv-03657, 2019 WL 118595 (N.D. Cal. Jan. 7, 2019) (denying defendant's request to disclose the identity of the funder backing the plaintiff because the request did not identify a specific showing of relevance).

[481] *See, e.g.*, Greenberg, *supra* note 2.

This addendum refocuses back to the need for domestic TPF disclosure in mediation and brings to life the importance of TPF disclosure in mediation practice. In Section One, this discussion begins by distinguishing mediation from adjudicatory processes, showing how mediation's distinct values and purposes call for the adoption of TPF disclosure. Section Two will explain what is meant by disclosure. Once the identity of the TPF is disclosed, Section Three clarifies how third-party funders, with their enhanced settlement acumen, bring value-added benefits to the mediation table. Included in this section will be the views of an industry actor whose participation during in-person mediations helped facilitate the resolution of his firm's funded cases. This addendum then concludes with a renewed call to action to dispute resolution professionals, funded parties, and funders to implement practices and procedures that encourage TPF disclosure in mediation.

SECTION ONE

Third-party funding disclosure should become a required mediation practice to safeguard mediation's purpose, practice, and ethical underpinnings.[482] Unlike adjudicatory processes, mediation is a party-directed dispute resolution process that should require the disclosure of TPF to preserve mediation's transparency and to foster trust among mediation participants, distinguishing components of mediation's practice ethos.[483] Mediation, in its most basic form, is an assisted negotiation in which the mediator helps the parties reach a resolution to the presenting conflict, as the conflict is defined by the parties.[484] Although ADR processes like arbitration and mediation are confidential if the parties so desire, their confidentiality purposes are somewhat different.[485] What distinguishes

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[482] *See, e.g.*, Elayne E. Greenberg, *Ethical Compass: When the Empty ADR Chair Is Occupied by a Litigation Funder,* NYSBA N.Y. DISP. RESOL. LAW., Spring 2017, at 7; Greenberg, *supra* note 2.

[483] Andrea Maia, *Transparency Is a Necessary Requirement to Find the Way for the Best Agreement*, KLUWER MEDIATION BLOG (Oct. 25, 2012), http://mediationblog.kluwerarbitration.com/2012/10/25/transparency-is-a-necessary-requirement-to-find-the-way-for-the-best-agreement/; Joseph Folger, *Harmony and Transformative Mediation Practice: Sustaining Ideological Differences in Purpose and Practice,* 84 N.D. L. REV. 823 (2008).

[484] *See, e.g.*, *A Guide to the Mediation Process for Lawyers and Their Clients*, JAMS MEDIATION SERVS., https://www.jamsadr.com/mediation-guide (last visited Dec. 1, 2019).

[485] Compare the provisions for confidentiality at arbitration, *see, e.g.*, *AAA Statement of Ethical Principles*, AM. ARB. ASS'N, https://www.adr.org/StatementofEthicalPrinciples (last

mediation from adjudicatory processes such as arbitration and litigation is that mediation participants—protected with the cloak of confidentiality and guided by the skill of the mediator—collaborate to develop a party-directed resolution of the presenting issue in their case, as well as any underlying problems and ancillary issues.[486]

TPF disclosure in mediation is essential to promoting the candor, understanding, and problem-solving that are hallmarks of mediation conflict discourse.[487] Distinguishable from the conflict discourse in arbitration and litigation, mediation conversations, including conversations about TPF disclosure, are not cloistered by the procedural rules of evidence or discovery.[488] This frees mediation participants to engage in conflict conversations that are candid rather than positional rants.[489] In this unshackled milieu, mediation participants often discover that their conflict discourse evolves from conversations of blaming to conversations that help develop a deeper understanding of the problem and a willingness to collaboratively shape a responsive resolution to the problem at hand.[490] Evolving from this candor, deeper understanding, and collaboration that take place in mediation, mediation participants and the mediator begin to develop the trust needed to shape a durable, party-directed agreement.[491] As discussed more fully below, the

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visited Dec. 1, 2019) (arbitration is a private process that is not subject to public access such as litigation), with those for mediation, *see, e.g.*, Kimberly Taylor, *Mediation: Confidentiality and Enforceability of the Process*, JAMS (Apr. 6, 2015), https://www.jamsadr.com/blog/2015/mediation-confidentiality-and-enforceability

[486] Taylor, *supra* note 12.

[487] Taylor, *supra* note 12; Greenberg, *supra* note 2.

[488] *See* David W. Henry, *Mediation as a Dark Art: A Mediator's Message to Parties Seeking to Settle the Difficult Case*, AM. BAR ASS'N (Mar. 22, 2014), https://www.americanbar.org/groups/business_law/publications/blt/2014/03/02_henry/ ("[A] lawyer's knowledge of evidence and procedure is of little value.").

[489] Taylor, *supra* note 12.

[490] *See, e.g.*, MODEL STANDARDS OF CONDUCT FOR MEDIATORS § VI(A)(4) (AM. ARB. ASS'N 2005) ("A mediator should promote honesty and candor between and among all participants, and a mediator shall not knowingly misrepresent any material fact or circumstance in the course of a mediation."). *See generally* ERIC GALTON & LELA P. LOVE, STORIES MEDIATORS TELL (2012).

[491] *See, e.g.*, Richard Salem, *Trust in Mediation*, BEYOND INTRACTABILITY (July 2003), https://www.beyondintractability.org/essay/trust_mediation; Frances E. McGovern, *Trust and the SRBA Mediation*, 52 IDAHO L. REV. 335 (2016).

disclosure of TPF in mediation can contribute to the mediation conflict discourse by offering the funder's objective assessment of the case and suggesting workable options for settlement.

The disclosure of third-party funders at the beginning of the mediation is also implicitly required to preserve ethical mediation practice.[492] The Model Standards of Conduct for Mediators, the mediator ethical code that contours the ethical underpinnings of mediation, mandates that mediators oversee a mediation process that promotes party self-determination,[493] maintains mediator impartiality,[494] discloses real or perceived conflicts,[495] safeguards confidentiality,[496] and preserves the integrity of the process.[497] As one example, disclosure about the third-party funder would contribute to the scope of information mediation participants would need to give their meaningful informed consent to proceed with mediation and, ultimately, consent to any resolution. Mediation participants could not give their meaningful informed consent, the essence of party self-determination, if a funded party failed to disclose the identity of the funder.[498] Perhaps, once a mediation participant learns that the other mediation participant is funded, the unfunded participant may reassess her

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[492] *See, e.g.*, Greenberg, *supra* note 2.

[493] MODEL STANDARDS OF CONDUCT FOR MEDIATORS § I(A) (AM. ARB. ASS'N 2005) ("A mediator shall conduct a mediation based on the principle of party self-determination. Self-determination is the act of coming to a voluntary, uncoerced decision in which each party makes free and informed choices as to process and outcome. Parties may exercise self-determination at any stage of a mediation, including mediator selection, process design, participation in or withdrawal from the process, and outcomes.").

[494] *Id.* § II(A) ("A mediator shall decline a mediation if the mediator cannot conduct a mediation in an impartial manner. Impartiality means freedom from favoritism, bias or prejudice.").

[495] *Id.* § III(A) ("A mediator shall avoid a conflict of interest during and after a mediation. A conflict of interest can arise from involvement by a mediator with the subject matter of the dispute or from any relationship between a mediator and any mediation participant, whether past or present, personal or professional, that reasonably raise a question of a mediator's impartiality.").

[496] *Id.* § V(A) ("A mediator shall maintain the confidentiality of all information obtained by the mediator in mediation, unless otherwise agreed to by the parties or required by the applicable law.").

[497] *Id.* § VI(A) ("A mediator shall conduct a mediation in accordance with these Standards and in a manner that promotes diligence, timeliness, safety, presence of the appropriate participants, party participation, procedural fairness, party competency and mutual respect among all participants.").

[498] *Id.* § I(A) ("Self-Determination").

evaluation of the case, reconsider if mediation is appropriate, rethink her mediation advocacy strategy, and re-evaluate the viable parameters of settlement.[499]

In a second illustration, TPF disclosure at the beginning of the mediation maintains the integrity of mediation by addressing any potential conflicts of interest that may exist among the funders, neutrals, and other mediation participants. If a funded party failed to disclose that fact to the mediator and the other mediation participants at the outset, the mediator participant might proceed with an unknown conflict of interest with the TPF. Even if the fact of funding was disclosed later in the mediation or discovered at the conclusion of the mediation, the integrity of the mediation process would be compromised and the basis of any agreement would be put at risk.[500] In a third example, disclosure of third-party funders allows mediators to structure a mediation process of integrity which "promotes . . . the presence of appropriate parties."[501] Third-party funders should be considered "appropriate parties" since the contractual agreement between third-party funders and the funded parties often requires, at a minimum, that the funded party consult and share information as the case proceeds to resolution. In mediation, "appropriate parties" is more of a term of art that includes anyone that might contribute to the mediation discussion and influence the settlement discussions.[502]

An unexplored ethical issue is whether, if at all, the disclosure of a third-party funder compromises mediator impartiality.[503] This author speculates that the

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[499] *Id.*

[500] *Id.* § VI ("Quality of the Process").

[501] *Id.*

[502] *See, e.g.*, Mark J. Bunim, *A Twist in Standard Mediation: The Insurer Is at the Table,* N.Y.L.J. (July 29, 2010), https://www.law.com/newyorklawjournal/almID/1202463997409/a-twist-in-standard-mediation-the-insurer-is-at-the-table/# (raising the importance of having an insurance representative with settlement authority at the mediation table); DWIGHT GOLANN, SHARING A MEDIATOR'S POWERS: EFFECTIVE ADVOCACY IN SETTLEMENT (2013) (suggesting that during the pre-mediation phase, mediators should discuss with the attorneys who are the people needed to attend the mediation to help make the mediation successful); Greenberg, *supra* note 2 at 154 (explaining why mediators need to know about the relationship between the mediation party and their third-party funder).

[503] *Id.* § II(A) ("Impartiality"). When the author presented the idea of TPF disclosure in arbitration and mediation at conferences, neutrals raised repeated concerns about how such disclosure might affect their impartiality. Marc Goldstein? Marc Goldstein was one of

answer to this question depends on the individual mediator. As mentioned in the beginning of this article, the polarizing debate about third-party funders has publicly depicted third-party funders either as a needed-good that helps parties access justice, or as a modern-day version of the medieval justice evils of barratry, champerty, and maintenance. Thus, at this point in time, individual mediators may be swayed by information on either end of the spectrum, or maintain an agnostic stance about third-party funders.[504]

Thus, TPF disclosure in mediation comports and advances mediation's purpose and ethics. An unresolved question that is addressed in the next section is what should be the appropriate scope of TPF disclosure.

SECTION TWO

The elephant in the room and in this paper is, if there is mandatory third-party disclosure in mediation, what should be the scope of that disclosure? Disclosure is a not a binary analysis, but rather a complex inquiry that requires a nuanced examination of that which is disclosed and what, if anything, should remain confidential. Disclosure should be titrated and multi-level, consistent with the purpose, goals, and ethics of mediation.[505] First, the names of the funder should be disclosed to see if there is a conflict with the neutral provider or any other mediation participants.[506] Second, if there are no conflicts and/or any conflicts are waived and the mediation proceeds, the TPF should sign the mediation confidentiality agreements to preserve the confidentiality of mediation communications.[507] Third, as the mediation proceeds, the funded party should disclose the financial arrangement between the TPF and the funded party so that the mediator and the mediation participants better understand the funded party's economic considerations when considering settlement. Fourth, the TPF should disclose the funder's objective assessment of the case if it will help overcome any

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those arbitrators I had discussed this with. Can I have the sentence without his name? I think so. I can just delete it.

[504] Although all judges, arbitrators, and mediators have biases, mediators' biases are more likely to emerge in a mediation setting because of mediation's informal structure and lack of procedural rules. *See, e.g.*, Greenberg, *supra* note 2 (citing to the work of Tversky & Kahneman, Banaji & Greenwald and Daniel Ariely).

[505] Greenberg, *supra* note 2.

[506] Greenberg, *supra* note 2.

[507] Greenberg, *supra* note 2.

impasses to settlement.[508] Addressing a concern expressed by TPFs, the disclosure of the TPF's cases assessment does not have to include any proprietary information. As with all expert assessments that assist mediation participants to make rational and objective assessments about their disputes, however, the disclosure of a TPF's case assessment could help mediation participants reassess the merits of their case.[509]

Some third-party funders, however, have maintained a stance against disclosure, arguing that any disclosure about third-party funders will threaten the third-party funder's proprietary work. Other funders, like Mr. Boaz Weinstein, co-founder and partner of Lake Whillans Litigation Finance, take a more reasoned approach to funding disclosure.[510] Mr. Weinstein expounded on his views about the disclosure:

" . . .we do not object to disclosure provided that (i) disclosure is limited to the fact of funding (i.e., that the fact that there is funding and the identity of the funder is disclosed), rather than the terms (i.e., the opposing party does not get to know the specific terms of funding such as amount, returns, priority, etc.); and (ii) disclosure is enacted as part of a broader 'holistic' regime that takes up not just the question of whether the identity of the funder is disclosed but also the question of what discovery is permitted regarding that funding. In other words, it does not make sense to us to examine the question of disclosure in isolation and then have lots of discovery battles over what documents can be obtained from the claimholder/funder regarding funding. While there is a substantial body of law that has been built up rejecting such forays, it would be best if there were clear guidance put in place at the same time as disclosure rules are put in place."[511]

Still others believe the answer to the scope of third-party disclosure depends on how you characterize third-party funders.[512] Some analogize third-party funding

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[508] *See* Greenberg, *supra* note 2 at 155 (discussing how the decision to disclose raises whether attorney-client privilege will be waived or preserved).

[509] Greenberg, *supra* note 2.

[510] Telephone interview with Boaz Weinstein, Co-founder and Partner, Lake Whillans Litig. Fin. (Nov. 15, 2019) [hereinafter "Phone conversation"] (notes of the conversation on file with author)).

[511] Email from Boaz Weinstein, Co-founder and Partner, Lake Whillans Litig. Fin., to author, (Nov. 26, 2019) (on file with author).

[512] *See, e.g.*, Victoria Sahani, *Reshaping Third-Party Funding*, 91 TUL. L. REV. 405 (2017); Charles Silver, *Litigation Funding Versus Liability Insurance: What's the Difference?*, 63

to insurance.[513] According to such thinkers, third-party funding, as with insurance, should be obligated to disclose the complete terms of their agreement[514] and be available to fully participate in settlement procedures such as mediation.[515] Amidst all these seemingly divergent opinions regarding disclosure, there appears growing consensus that if there is to be any disclosure, there should be disclosure just to check for any conflicts. Still, the major ADR providers have yet to take this first step. The next section shows how the in-person participation of a TPF in mediation not only advances mediation's ethics and purpose, but brings enhanced settlement skill to the mediation table.

SECTION THREE

When third-party funders participate in the in-person mediation, they bring to the mediation table their settlement acumen, a "value-added" benefit that helps mediation parties develop a more rational and realistic approach to settlement. Third-party funders are, in fact, "super lawyers" whose business success depends on accurately assessing the merits of a case seeking funding.[516] To date, however, third-party funders have not regularly participated in domestic in-person mediations, at a cost to funded-mediation participants. *Don't ask, don't tell.*

For some funded mediation participants and their funders, the discussion of having third-party funders actually attend the in-person mediation evokes the long-term negotiating tension between creating value and distributing value, the decision to share information or withhold information.[517] Because of this tension,

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DEPAUL L. REV. 617 (2014); Michelle Boardman, *Insurers Defend and Third Parties Fund: A Comparison of Litigation Participation*, 8 J.L. ECON. & POL'Y 673 (2012).

[513] *See, e.g.*, Silver, *supra* note 39. *But see* Miller UK Ltd. v. Caterpillar, Inc., 17 F. Supp. 3d 711 (N.D. Ill. 2014) (distinguishing litigation funding from insurance).

[514] *See* Silver, *supra* note 39.

[515] Bunim, *supra* note 29.

[516] *See, e.g.*, Caroline Simson, *3rd-Party Funding Now a Top Alternative Choice for Lawyers*, LAW360 (May 16, 2019, 7:24 PM), https://www.law360.com/articles/1160547/3rd-party-funding-now-a-top-alternative-choice-for-lawyers; Sara Randazzo, *The New Hot Law Job: Litigation Finance,* WALL ST. J. (July 5, 2018), https://www.wsj.com/articles/the-new-hot-law-job-litigation-finance-1530783000

[517] ROBERT H. MNOOKIN ET AL., BEYOND WINNING: NEGOTIATING TO CREATE VALUE IN DEALS AND DISPUTES 17 (2000) (Negotiators often remain blinded by the fear that if they disclose information, they will be exploited by the other side. This fear obstructs negotiators to appreciate how disclosure may create value in the negotiation.).

funded mediation participants and their funders may be apprehensive about disclosing that they are receiving third-party funding, in fear that the other participant will exploit that information to the other participant's advantage. Although savvy negotiators have conquered this fear by applying the principle of reciprocity in negotiations to test the goodwill of their negotiating counterpart and minimize the risk of sharing too much information,[518] some funded parties remain unconvinced. Moreover, even though some scholars have extolled the benefits of having third-party funders participate in mediation, some have discounted this sage as just an academic's verbal pontification.[519]

However, the real-life mediation participation experience of a respected third-party funder like Boaz Weinstein may help ameliorate that concern. Mr. Weinstein has opted to participate in mediation in those cases where the funded party requested his participation, and he thought his presence in the role of funder would be helpful.[520] "We are in favor of settlement and negotiated resolutions."[521] In those mediations in which he participated, Mr. Weinstein brought a "value-add" to the process.[522] Mr. Weinstein noted that as a mediation participant, third-party funders are rational decision-makers who have experience in settlement.[523] They have a fluency with numbers and understanding of the mediation process that help the parties fashion a realistic settlement. And the presence of the funder provides welcome support to the funded party.[524] Of course, as a mediation participant, Mr. Weinstein signed confidentiality forms so that the cloak of confidentiality was maintained.

Mr. Weinstein posits that, since a small minority of cases that apply for funding are actually funded, the mere disclosure that a party is funded signals that a case has merit.[525] Further, should the case not settle, the funded party has the capacity

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[518] ROBERT B. CIALDINI, INFLUENCE: THE PSYCHOLOGY OF PERSUASION 17 (2007).

[519] This author has received this concern in her presentations about the benefits of third-party disclosure.

[520] Phone conversation, *supra* note 37.

[521] Phone conversation, *supra* note 37.

[522] Phone conversation, *supra* note 37.

[523] Phone conversation, *supra* note 37.

[524] Phone conversation, *supra* note 37.

[525] Phone conversation, *supra* note 37.; Greenberg, *supra* note 2.

to follow through on the claim.[526] Mr. Weinstein recounted how it wasn't until one of his funded parties disclosed in mediation that he was funded, that the funded party's litigation claim was taken seriously.[527] The other party had erroneously thought that the plaintiff did not have the economic muscle to follow through on his claim, and this disclosure "changed the tenor" of the mediation.[528]

While further research is required to determine the true impact of TPF disclosure on parties' behavior, intuition and anecdotal evidence suggest that the disclosure and even direct participation of TPFs in mediation may bring substantial "value added" to settlement discussions. Hopefully, these contributions will help shape realistic and durable mediated agreements for parties

CONCLUSION

This is a renewed call to action for domestic ADR providers, mediators, attorneys who represent funded parties in mediation, and third-party funders themselves to reconsider the value of third-party disclosure in mediation and to take affirmative steps to promote TPF disclosure. The ethics, purpose, and practice of mediation require TPF disclosure in mediation. Moreover, the "value added" by third-party funders' participation in mediation optimizes the likelihood of realistic and durable settlements. *Please ask, please tell.*

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[526] Phone conversation, *supra* note 37.

[527] Phone conversation, *supra* note 37.

[528] Phone conversation, *supra* note 37.

Disclosure of Third-Party Funding in International Arbitration

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INTRODUCTION TO THIRD-PARTY FUNDING

Third-party funding has evolved into a ubiquitous "feature of modern litigation" that in some jurisdictions is "an accepted and judicially sanctioned activity perceived to be in the public interest."[529] Similarly, third-party funding has become even more prevalent in international arbitration, particularly considering the high dollar amount of most arbitral awards. In addition, several major arbitration seats have officially embraced third-party funding in international arbitration through legislation or court opinions, including Australia, England, and Wales, most of the states in the United States, Germany, the Netherlands, several provinces in Canada, Singapore, Hong Kong, South Africa, and Nigeria (indirectly).[530] Furthermore, there are many other jurisdictions where third-party funding may be happening, but no official governmental response has yet ensued.

This article proceeds as follows. The remainder of this introduction defines third-party funding, describes basic third-party funding transaction structures, and outlines the major debates surrounding the existence of third-party funding in international arbitration. Next, this article outlines the reasons and scope for disclosure and describes rules and guidelines for third-party funding as articulated by institutions, arbitral tribunals, domestic courts, treaties, and domestic legislation. This article then addresses third-party funders as custodians of confidential information and charges them with ensuring the legitimacy of the arbitration process and preventing arbitrator conflicts of interest. Finally, this article addresses the rising influence of "outcome-motivated" (or not-for-profit) funders, whose primary focus is something other than making a financial profit from the case.

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[529] Excalibur *Ventures v. Texas Keystone*, [2016] EWCA (Civ) 1144, paras. 1 and 31.

[530] *See generally* LISA BENCH NIEUWVELD & VICTORIA SHANNON SAHANI, THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION (Wolters Kluwer, 2nd ed., 2017) (identifying laws addressing third-party funding or litigation funding in over 60 countries worldwide, including within the United States chapter all 50 states, the District of Columbia and Puerto Rico); Robert Wheal, Elizabeth Oger-Gross, Tolu Obamuroh & Gustav Lexner, *Third Party Funding in Arbitration: Reforms in Nigeria*, WHITE & CASE (Nov. 27, 2018), https://www.whitecase.com/publications/alert/third-party-funding-arbitration-reforms-nigeria ("The Bill . . . effectively legalizes [sic] TPF in arbitration (but not litigation) in an indirect fashion. It does so by including the costs of obtaining TPF as part of costs of arbitration. In other words, the Bill does not expressly state that TPF will be legal, but the consequence of including it as part of costs of arbitration logically means that the Bill has tacitly permitted TPF.").

DEFINING THIRD-PARTY FUNDING

Before proceeding further, it is crucial to articulate a working definition for the term "third-party funder," while also recognizing that any definition will necessarily be both underinclusive and overinclusive of the universe of entities that may rightly be called "third-party funders."[531] The Task Force on Third-Party Funding in International Arbitration, jointly organized by the International Council for Commercial Arbitration (ICCA) and Queen Mary University of London School of Law, is one of the most recent entities to promulgate a universal definition of third-party funding in its final report published in April 2018.[532] Although the Task Force's Report does not address all aspects, questions, and potential problems involving third-party funding, it does address a wide variety of pertinent issues, including definitions, disclosure, conflicts of interest, evidentiary privileges, costs and security for costs, investment arbitration, and general principles of best practice, as a starting point for a worldwide discussion of these issues. The Task Force dedicates Chapter 3 of its report to discussing the intricacies of the debate surrounding how to properly define third-party funding and provides more than one definition of third-party funding to address different contexts. In fact, the report does not settle upon a single definition of third-party funding, but rather the report articulates multiple nuanced definitions that may apply depending on the circumstances and characteristics of the situation.

This article adopts the following generalized definition articulated in Chapter 3 of the Task Force Report:

The term 'third-party funding' refers to an agreement by an entity that is not a party to the dispute to provide a party, an affiliate of that party or a law firm representing that party,

a) funds or other material support in order to finance part or all of the cost of the proceedings, either individually or as part of a specific range of cases, and

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[531] *See* Victoria Anne Shannon, *Harmonizing Third-Party Litigation Funding Regulation*, 36 CARDOZO L. REV 861, 866 n.20 (2015) (discussing the difficulty in defining third-party funding and third-party funders).

[532] ICCA QUEEN MARY TASK FORCE REPORT ON THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION (International Council for Commercial Arbitration 4th ed. 2018), http://www.arbitration-icca.org/publications/Third-Party-Funding-Report.html [hereinafter TASK FORCE REPORT].

b) such support or financing is either provided in exchange for remuneration or reimbursement that is wholly or partially dependent on the outcome of the dispute, or provided through a grant or in return for a premium payment.[533]

In essence, a "third-party funder" is an entity that is neither a party to the arbitration nor a party's legal counsel that "provides the financial resources to enable costly litigation or arbitration cases to proceed."[534] The third-party funder may provide such financing to a single party directly or to a law firm representing one or more parties in one or more disputes.[535] Unlike a traditional lender, if the funded party loses the case, the funder may not seek repayment from any other assets of the funded party.[536]

Finally, it is important to note that third-party funding is not only used by impecunious parties. There are many corporate entities that use third-party funding as a form of corporate finance to raise money for the company, allocate risk, maintain liquidity, or to smooth out the dispute resolution costs line item on the company's balance sheet, if the company finds itself with a steady stream of disputes.[537] Third-party funding can also take the form of a type of litigation expenses insurance, such as after-the-event or before-the-event insurance, for a financially sound individual or entity that may expect to be sued in the future.[538] Thus, it is not appropriate for an opposing party to apply for security for costs (e.g.,

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[533] TASK FORCE REPORT, *supra* note 4, at 50. Note that the Task Force addressed only international arbitration, so consumer third-party funding was not addressed in the report.

[534] *See* Association of Litigation Funders, *Litigation Finance: What is litigation funding*?, http://associationoflitigationfunders.com/litigation-finance/

[535] *Id.* ("Some members of the Association of Litigation Funders also provide financing to law firms wishing to manage their exposure to conditional fee arrangements in litigation work, and can offer financing against other litigation-related risks, such as a portfolio of litigation claims.").

[536] *Id.* ("In return, if the case is won, the funder receives an agreed share of the proceeds of the claim. If the case is unsuccessful, the funder loses its money, and nothing is owed by the litigant.").

[537] *See* Sherina Petit, James Rogers & Cara Dowling, *Third-Party Funding in Arbitration - the Funders' Perspective: A Q&A with Woodsford Litigation Funding, Harbour Litigation Founding and Burford Capital*, NORTON ROSE FULBRIGHT INT'L ARB. REP., no. 7, Sept. 2016, at 3 (on file with author).

[538] *See generally* LISA BENCH NIEUWVELD & VICTORIA SHANNON SAHANI, THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION (Wolters Kluwer, 2nd ed., 2017) (explaining the use of after-the-event and before-the-event insurance in multiple jurisdictions).

posting a bond or letter of credit to cover any potential costs award against the losing party) simply because the opposing side has a third-party funder, unless there is additional evidence indicating that the funded party is also impecunious. This principle was articulated by the tribunals in the *RSM v. Saint Lucia*, *EuroGas v. Slovak Republic*, and *South American Silver v. Bolivia* cases, discussed later in this article.

The menu of possible third-party funding arrangements is complex, innovative, and ever-changing, so there are undoubtedly third-party funding arrangements not covered by the aforementioned definition.[539] Nevertheless, the definition from the Task Force Report, reproduced above, provides a reasonable, well-defined platform from which to describe how disclosure of third-party funding international arbitration operates.

THIRD-PARTY FUNDING TRANSACTION STRUCTURES

There are a seemingly endless number of structures and types of third-party funding, and the industry is devising new financial products at a rapid pace. Traditional (at this point, almost classic) third-party funding is structured as an investment in the costs of international arbitration that the funded party must repay to the funder plus some calculated amount of profit only if the funded party wins the case.[540] Most third-party funders, however, have created and deployed innovative, new financial products beyond this traditional structure. This article addresses third-party funding structures that fall roughly into three major categories. First, there are third-party funding structures in which the funder

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[539] For example, in defense-side funding, the respondent typically does not recover any funds from the arbitration, unless the respondent lodges a successful counterclaim or is awarded costs against the claimant. *See* Victoria Anne Shannon, *Harmonizing Third-Party Litigation Funding Regulation*, 36 CARDOZO L. REV. 861, 876, 892, 894-895 (2015). Defense-side funding, however, is not nearly as common in international arbitration as claim-side funding, so this article focuses more on the role of third-party funders in claim-side funding of international arbitration. For an in-depth analysis of the problems of defining the terms “third-party funder” and “third-party funding,” *see generally Chapter 3, in* TASK FORCE REPORT, *supra* note 4. Another example is third-party funding used as a type of corporate finance. *See* Sherina Petit, James Rogers & Cara Dowling, *Third-Party Funding in Arbitration - the Funders’ Perspective: A Q&A with Woodsford Litigation Funding, Harbour Litigation Founding and Burford Capital*, NORTON ROSE FULBRIGHT INT’L ARB. REP., no. 7, Sept. 2016, at 3 (on file with author).

[540] *See* LISA BENCH NIEUWVELD & VICTORIA SHANNON SAHANI, THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION 3 (Wolters Kluwer, 2nd ed., 2017).

remains a separate entity, as in traditional or classic third-party funding. Moreover, funders now regularly package those classic third-party funding investments into portfolios to hedge risk, as well as provide money directly to law firms to finance multiple cases that the law firm is handling.[541]

Second, some newer innovations involve a third-party funder becoming part of the funded party.[542] An example of this arrangement is when the third-party funder takes an equity stake in the funded party, via direct ownership or as a shareholder, in exchange for its investment.[543] Another example is the third-party funder and funded party creating a joint-venture entity or special-purpose entity into which the funded party transfers ownership of the claim; then, the newly created entity that owns the claims becomes the named party to the case.[544]

Third, in the future, this author predicts that third-party funders will increasingly take equity stakes in law firms or build their own law firms from inception.[545] There are already a few examples of this phenomenon in existence.[546] This will likely become increasingly common in the coming years as the legal profession becomes more corporatized and gains greater access to traditional methods of corporate finance that have existed for decades in the private sector.[547]

There are also other types of financial arrangements that could be classified as third-party funding. For example, non-profit funding involves an entity or individual funding a case (usually only a single case or party) for a reason other than profit, such as to bring about a specific outcome in the case or to support a particular industry, regulation, or political goal.[548] There are also types of before-

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[541] *See* Victoria Sahani, Mick Smith & Christiane Deniger, *Third-Party Financing in Investment Arbitration*, CONTEMPORARY AND EMERGING ISSUES ON THE LAW OF DAMAGES AND VALUATION IN INTERNATIONAL INVESTMENT ARBITRATION 33 (Christina L. Beharry ed., 2018), https://brill.com/abstract/book/edcoll/9789004357792/BP000010.xml (discussing not-for-profit funders)

[542] *See* Victoria Shannon Sahani, *Reshaping Third-Party Funding*, 91 TULANE L. REV. 405, 435-444 (2017) (discussing funder-party collaborations involving creating new corporate or partnership structures).

[543] *Id.*

[544] *Id.*

[545] *Id.* at 444-70 (discussing funder investment in law firms and ownership of law firms).

[546] *Id.*

[547] *Id.* at 408-09, 455 (describing the example of the United Kingdom's Legal Services Act 2007, c. 29 (Eng.) that took effect in 2013 allowing Alternative Business Structures, which enables external non-lawyer investors to hold minority stakes in law firms, and providing the example of one third-party funder, Burford, creating a new law firm under this law).

[548] *See* Victoria Sahani, Mick Smith & Christiane Deniger, *Third-Party Financing in*

the-event, after-the-event, legal expenses, or liability insurance policies — the main form of defense-side third-party funding — as well as defense clubs organized by certain industries, such as the shipowners industry.[549] Many of those types of financing for legal expenses predate the existence of classic third-party funding, even though they share similar characteristics.

In addition to these recognizable structures, the range of bespoke financial products that third-party funders offer — individualized and tailored to a particular client, case, or business need — will continue to morph and expand like a spider's web. The rate of change is such that, by the time this article is in print, there undoubtedly will be new types of third-party funding available that did not exist at the time of this writing.

DEBATING THE EXISTENCE OF THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION

With such rapid expansion and adoption come increasing avenues for debate about the future of third-party funding. When third-party funding was newer, the arguments against its use in international arbitration included funder interference in the attorney-client relationship, waiver of evidentiary privileges for information disclosed to the funder, funders stirring up frivolous or dubious claims, funder influence over client settlement decisions, undisclosed conflicts of interest that funder participation may create, and lack of transparency, among other issues.[550] In recent years, there has been a widespread acceptance of third-party funding in international *commercial* arbitration — even among its harshest critics — albeit with heightened calls for disclosure of the existence and identity of funders in international arbitration, a position ultimately adopted by the final report of the aforementioned Task Force.[551] The argument that has prevailed in international commercial arbitration is that, essentially, claimants are entitled to

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Investment Arbitration, CONTEMPORARY AND EMERGING ISSUES ON THE LAW OF DAMAGES AND VALUATION IN INTERNATIONAL INVESTMENT ARBITRATION 48-50 (Christina L. Beharry ed., 2018), https://brill.com/abstract/book/edcoll/9789004357792/BP000010.xml (discussing not-for-profit funders).

[549] *See* TASK FORCE REPORT, *supra* note 4, at 6, 9-10 (discussing traditional insurance that pays legal expenses and maritime arbitration defense clubs).

[550] *See, e.g.,* LISA BENCH NIEUWVELD & VICTORIA SHANNON SAHANI, THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION 15-16 (Wolters Kluwer, 2nd ed., 2017).

[551] *See* TASK FORCE REPORT, *supra* note 4, at 81.

the same access to justice regarding financial assistance with their arbitrations that respondents enjoy through their insurance companies and parent corporations. Thus, the future of third-party funding in international *commercial* arbitration appears to be relatively settled in favor of the continuation of the industry, with added disclosure requirements and other rules and regulations that will likely be adopted in future years.[552]

The current battleground regarding the propriety of third-party funding is in the realm of *investment* arbitration. Funding investment treaty arbitration is viewed as a fundamentally different proposition than funding commercial arbitration. In investment arbitration, the rigidity of the parties' roles may create lopsided funding incentives. When the investor and host state sign a separate contract, such as a concession agreement, they each have an equal opportunity to bring claims against each other according to their contractual dispute resolution method, which may be arbitration. Third-party funding in that context would be similar to international commercial arbitration.

When there is no pre-dispute arbitration clause or contract between the investor and the host state, however, the consent to arbitrate must be found in the bilateral or multilateral investment treaty ratified by the host state and the investor's home state. The investor is not a party to the treaty, so the investor's "written" consent is evidenced by the investor filing a claim under Articles 25 and 28 of the ICSID Convention or under the provisions of the investment treaty. The state is always the respondent, and it is extremely rare for investment treaties to provide express consent for host states to bring counterclaims, at least partly because the arbitral tribunal's jurisdiction over such counterclaims is dubious under traditional investment treaties.[553] Thus, third-party funders typically fund only investor-

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[552] *See, e.g.*, Tom Jones, *Kinnear Sheds Light on ICSID Rules Amendment*, GLOB. ARB. REV., (Apr. 6, 2018), https://globalarbitrationreview.com/article/1167749/kinnear-sheds-light-on-icsid-rules-amendment

[553] There is, however, at least one recent treaty that may provide jurisdiction for a host state to bring a claim against an investor in domestic litigation. *See* Tarcisio Gazzini, *The 2016 Morocco–Nigeria BIT: An Important Contribution to the Reform of Investment Treaties*, INVESTMENT TREATY NEWS (Sept. 26, 2017), https://www.iisd.org/itn/2017/09/26/the-2016-morocco-nigeria-bit-an-important-contribution-to-the-reform-of-investment-treaties-tarcisio-gazzini/ (describing the innovations in this treaty, including putting obligations on investors to comply with the laws of the host state and providing a state the opportunity to sue an investor in the courts of its home country for violations of the treaty obligations). While this treaty does not allow for a state to bring an investment arbitration claim against an investor, the treaty does provide a judicial route through which the state may be

claimants in investment arbitrations brought exclusively under a treaty; respondent-side funding in investment treaty-based arbitrations is nearly nonexistent.[554] Because the funder is always paid from the funds of the respondent in any type of dispute resolution, then the funder is always paid with funds from the respondent state in investment arbitration. In essence, states are the sole payers in a system of third-party funding for investment treaty arbitration in which they are unable to enjoy a benefit equivalent to investors' benefits. Fundamentally, this is the opposite side of the access to justice issue that arises in commercial arbitration — this is access to justice for respondents rather than claimants — which highlights one of the underlying structural problems in investment treaty arbitration.[555]

This structural problem will likely receive at least a partial answer in the future with respect to third-party funding. The International Centre for the Settlement of Investment Disputes (ICSID) has added provisions regarding the disclosure of third-party funding in Rule 14 of its revised Rules of Arbitration and will include provisions requiring the disclosure of third-party funding at the outset of the case.[556] In addition, at least four investment treaties, described later in this article, have already included provisions requiring disclosure of third-party funding.

Finally, third-party funding was discussed during the 34th session of the UNCITRAL Working Group, and it is possible that Working Group III will address third-party funding in its future deliberations.[557] In sum, it appears that, for now, the resounding call for mandatory disclosure in both commercial and investment arbitration is the international arbitration community's way of gleaning more

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compensated for any wrongs the investor commits under the treaty. In addition, the treaty is silent regarding whether states may bring counterclaims against investors in investment treaty arbitration, which may open the door to jurisdiction over such claims. The effects of these provisions will be tested if a case is eventually commenced under the treaty.

[554] There may be at least one notable exception. Narghis Torres, Co-Founder and CEO of LexFinance (http://www.lex-finance.com/), publicly stated, at an event titled "Third-Party Funding in Investor-State Dispute Settlement" hosted by Columbia Law School on October 17, 2017, that his firm regularly finances respondent states in investment arbitration, https://www.youtube.com/watch?v=ZPCtpZfPigw

[555] For a discussion of access to justice in international arbitration, *see generally* Victoria Shannon Sahani, *A Thought-Experiment Regarding Access to Justice in International Arbitration*, ICCA CONGRESS SERIES, no. 20, (2019).

[556] *See* International Centre for Settlement of Investment Disputes (ICSID) Secretariat, *Working Draft #3: Proposals for Amendment of the ICSID Rules*, at 41, 91 (Aug. 2019).

[557] *See* U.N. Comm'n on Int'l Trade Law (UNCITRAL), Rep. of Working Group III on the Work of Its Thirty-Fifth Session, U.N. Doc. A/CN.9/92935, para. 13 (2018).

information about the third-party funding industry to determine whether the industry should be further regulated at the international level.

PARAMETERS FOR DISCLOSURE OF THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION

The major individuals and entities involved in international arbitration — parties, attorneys, arbitrators, law firms, arbitral institutions, and courts — are *publicly* invested in the success of the international arbitration system. Until recently, third-party funders were *privately* — some might even say *secretly* — invested in the international arbitration system. Over the past few years, however, calls for disclosure of the existence of third-party funding and the identities of third-party funders have led arbitral tribunals, arbitral institutions, and state governments to begin to craft and implement various disclosure rules for third-party funding. The following section provides a survey of those disclosure rules as they exist at the time of this writing.

REASONS FOR DISCLOSURE

Arbitral tribunals typically find out about third-party funding through either voluntary or mandated disclosure. There are various motivations for disclosure, types of information disclosed, and recipients of the information disclosed. With respect to motivations for disclosure, theoretically, there are four major categories of motivation for this disclosure; three are required, while one is discretionary. First, a tribunal may require a party to disclose its third-party funding at the request of the opposing side in conjunction with the opposing side's application for costs or security for costs, which is tied to the implementation of a "loser pays" rule, commonly known as the "English rule," on cost allocation at the conclusion of an international arbitration.[558]

Second, a tribunal may require such disclosure so that the arbitrators can check for financial, professional, or personal conflicts of interest related to the third-party funding.[559] In such cases, arbitral rules or guidelines may require disclosure

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[558] *See, e.g.*, Muhammet Çap & Sehil Inşaat Endustri ve Ticaret Ltd Sti v. Turkm., ICSID Case No ARB/12/6, Procedural Order No. 3 (June 12, 2015); Kılıç İnşaat İthalat İhracat Sanayi ve Ticaret Anonim Şirketi v. Turkm., ICSID Case No ARB/10/1.

[559] *See* IBA Conflict Guidelines, General Standard 6(b), 7(a), the Orange List (section 3.4),

by arbitrators, who in turn may require disclosure from the parties in the case in order to determine what the arbitrators need to disclose.[560] Such disclosure obligations may also arise under rules of professional ethics and professional responsibility for lawyers and arbitrators under national law or arbitral rules. Furthermore, some investment treaties require funded parties to disclose their funding in order to utilize any dispute settlement mechanisms detailed in the treaty.[561] Third, many publicly held corporations are required to disclose any "material transactions" under the laws of their home jurisdictions.[562] Depending on the nature of the funding arrangement, a publicly held corporation entering into a funding arrangement may meet the definition of a "material transaction" that would require disclosure.[563] Fourth, parties may voluntarily choose to disclose their own funding arrangements to the opposing side to have a strategic influence on settlement discussions or on the outcome of the case. This type of disclosure is discretionary, and its actual effect on settlements or outcomes is debatable.

SCOPE OF DISCLOSURE

Whether disclosure is ordered by the tribunal or voluntarily achieved, there can be considerable variation regarding what information is disclosed from case to case. The variation could be described as a sliding scale regarding how much or how little information is disclosed. The most basic disclosure would be simply the fact that a funding arrangement exists without further detail. Often the identity and contact information of the funder is disclosed along with the existence of the funding arrangement to assist arbitrators in checking whether a conflict of interest may exist. Less often, certain characteristics or terms of the funding agreement

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and the Non-waivable Red List (section 1).

[560] *See* IBA Conflict Guidelines, General Standard 7(a); International Chamber of Commerce (ICC), *Note to parties and arbitral tribunals on the conduct of the arbitration under the ICC Rules of Arbitration*, para. 24, (Oct. 30, 2017), https://iccwbo.org/publication/note-parties-arbitral-tribunals-conduct-arbitration [hereinafter, *ICC Note to Parties and Tribunals*].

[561] *See e.g., Comprehensive Economic and Trade Agreement*, arts. 8.1, 8.26 (Sept. 14, 2016), http://data.consilium.europa.eu/doc/document/ST-10973-2016-INIT/en/pdf

[562] Jonas Von Goeler summarizes these obligations as follows: "Importantly, the presence of a third-party funder may need to be disclosed for reasons *not linked to the arbitration proceedings*, namely to comply with public disclosure requirements imposed upon listed companies, and following disputes between the parties to the funding agreement ending up in state courts." *See* JONAS VON GOELER, THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION AND ITS IMPACT ON PROCEDURE 128 (Wolters Kluwer, 2016) (italics in original).

[563] *Id.*

may be disclosed. This could range from a few key details, such as whether the funder has agreed in advance to pay security for costs, to an outline of the terms of the full agreement. Far more infrequently, part or all of the written funding arrangement may be disclosed pursuant to a tribunal order.[564] This almost never happens voluntarily, unless the funding agreement is the subject matter of the dispute. Finally, the funder's valuation of the case is almost never voluntarily disclosed. Typically, the only way that the funder's valuation would be disclosed is if it is written into the funding arrangement and the full written arrangement is disclosed, which is also rare. Also, the funder's valuation may not be informative from a practical perspective, because such valuations are prepared knowing that they may be produced to the tribunal and the opposing side, and therefore, such valuations may be sanitized or abbreviated to avoid revealing too much information about the funder's decision-making process.

In addition, there are generally three categories of recipients of the disclosed information. The first recipients are usually the immediate participants in the arbitration, such as the tribunal, the opposing parties, and the parties' counsel. Second, the arbitral institution may receive disclosure of the funding arrangement if the funder is paying fees and costs directly to an institution, or to check conflicts of interest, if the institution will be appointing arbitrator(s) directly. Third, a governmental regulatory body may receive disclosure of the third-party funding arrangement, for example, if a publicly held corporation must disclose such an arrangement to regulators or investors as a material transaction.[565]

SOURCES OF AUTHORITY REGARDING DISCLOSURE OF THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION

Institutional Rules and Guidelines

The first guidance on third-party funding in international arbitration was issued in 2014. The 2014 International Bar Association (IBA) Guidelines on Conflicts of Interest in International Arbitration (IBA Guidelines) were revised to incorporate provisions to require parties to disclose the existence of third-party funding and

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[564] *See infra* notes 586-593 and the accompanying text for a discussion of Muhammet Çap & Sehil Inşaat Endustri ve Ticaret Ltd Sti v. Turkm., ICSID Case No ARB/12/6, Procedural Order No. 3 (June 12, 2015).

[565] *Id.*

the identity of the funder to the arbitrators, who, in turn, are required to disclose any potential conflicts of interest to the parties and the arbitral institution.[566] Following such disclosure, an arbitrator may be required to decline an appointment or withdraw from a case, if the parties do not waive the conflict or if it is a conflict that cannot be waived.[567] Throughout the text, the IBA Guidelines define a third-party funder according to the attribute that funders "have a direct economic interest in the award."[568] As mentioned in the introduction to this article, the Task Force on Third-Party Funding in International Arbitration took a different approach to defining third-party funding, in part due to the challenges raised by variations in the interpretation of the phrase "direct economic interest" that arose in international arbitration discourse in the years following the issuance of the IBA Guidelines.

In December 2015, the International Chamber of Commerce (ICC) Commission on Arbitration issued a report entitled "Decisions on Costs in International Arbitration" that provided some guidance to arbitrators regarding third-party funding.[569] Notably, the commission provided a different definition of a third-party funder in its report than the definition in the IBA Guidelines: "A third-party funder is an independent party that provides some or all of the funding for the costs of a party to the proceedings (usually the claimant), most commonly in return for an uplift or success fee if successful."[570] The commission then provides the following guidance to tribunals: "Where a tribunal has reason to believe that

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[566] *See supra* notes 559-560 and accompanying text.

[567] An example of a potentially unwaivable conflict might be if an attorney is serving as arbitrator in a case where Party A is funded by funder X and the same attorney is simultaneously serving as counsel to Party B in a different case in which Party B is funded by the same funder X. Because funder X is paying the attorney representing Party B in Party B's case, the attorney must avoid even the appearance of bias while serving as an arbitrator in Party A's case in which funder X is also participating. This is likely an unwaivable conflict, although it is not directly mentioned in the IBA guidelines. To be safe, the arbitrator in this hypothetical should withdraw from judging Party A's case. The conflict might be waivable, however, if instead the arbitrator served successively as counsel, *then* arbitrator, rather than simultaneously as *both* counsel and arbitrator in two cases involving funder X.

[568] *See* IBA Conflict Guidelines, General Standard 6(b).

[569] *See* ICC Comm'n on Arb., *Decisions on Costs in International Arbitration - ICC Arbitration and ADR Commission Report*, at 16-17 (Dec. 1, 2015),, http://www.iccwbo.org/Advocacy-Codes-and-Rules/Document-centre/2015/Decisions-on-Costs-in-International-Arbitration---ICC-Arbitration-and-ADR-Commission-Report/ [hereinafter *ICC Costs Report*].

[570] *Id.* at 17 n.44.

third-party funding exists, and such funding is likely to impact on the non-funded party's ability to recover costs if successful, the tribunal might consider ordering disclosure of such funding information as is necessary to ascertain that the process remains effective and fair for both parties."[571] The report also provides a worldwide survey of laws regarding disclosure of third-party funding[572] and a worldwide survey of cost provisions in all international arbitration rules.[573] In addition, the report recommends that an arbitrator consider discussing with the parties, among other things, "sensitive matters, such as whether there is third-party funding and any implications it may have for the allocation of costs, whether the identity of the third-party funder (which could be relevant to possible conflicts of interest) should be disclosed, and whether contingency, conditional or success fee arrangements have been agreed, and how the parties expect these matters to be considered in relation to the assessment of costs."[574]

Surprisingly, the International Chamber of Commerce (ICC) Court of Arbitration seems to have adopted a definition of third-party funder that more closely resembles the IBA Guidelines than the ICC Commission's Report. In its *Note to parties and arbitral tribunals on the conduct of the arbitration under the ICC Rules of Arbitration* (30 Oct. 2017 version), the ICC Court gives arbitrators the following guidance in Paragraph 24: "Relationships between arbitrators, as well as relationships with any entity having a direct economic interest in the dispute or an obligation to indemnify a party for the award, should also be considered in the circumstances of each case."[575]

The Singapore International Arbitration Centre (SIAC) was, arguably, the first arbitral institution in the world to adopt an explicit rule on third-party funding, which took effect on January 1, 2017.[576] Rule 24(l) gives an arbitral tribunal in an investment arbitration the power to order disclosure of third-party funding, including the details of the arrangement itself.[577] Similarly, the China International Economic and Trade Arbitration Commission (CIETAC) incorporated Article 27 into the CIETAC Investment Arbitration Rules, which took

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[571] *Id.* at 17, para. 89.
[572] *Id.* at 45-46.
[573] *Id.* at 49-55 (Appendix C: Relevant Provisions of Arbitration Rules).
[574] *Id.* at 7, para. 32
[575] *See ICC Note to Parties and Tribunals, supra* note 32, para. 24.
[576] *See* SIAC Investment Rules, r. 24(1).
[577] *Id.*

effect on October 1, 2017, requiring disclosure of third-party funding and allowing arbitrators to order disclosure of the third-party funding agreement and to issue cost orders relating to third-party funding.[578]

In its Working Paper #3, published in August 2019, the International Centre for Settlement of Investment Disputes (ICSID) has incorporated a new draft of Rule 14 in its arbitration rules and Rule 12 in its conciliation rules requiring disclosure of third-party funding to the ICSID Secretary-General in order to check for arbitrator or conciliator conflicts of interest.[579] The rule also states that the ICSID Secretary-General will transmit the notice to the parties and the arbitrators in order to assist in checking for conflicts of interest. ICSID is expected to finalize its rule revisions by early 2020.

ARBITRAL TRIBUNALS

Many tribunals have articulated principles regarding disclosure of third-party funding in international arbitration such that it would be impossible to describe every decision in this brief article. Instead, this article provides highlights regarding trends in how tribunals have addressed third-party funding in international arbitration. Most of the decisions discussed in this article are decisions in investment arbitration cases, due to the public nature of many investment arbitration awards and procedural orders. In contrast, most commercial arbitration awards remain private and, therefore, are unable to be included in this article's sampling.

In some cases, the funded party has voluntarily disclosed funding without any adverse consequences, such as in the UNCITRAL investment arbitration case *Oxus Gold plc v Republic of Uzbekistan*[580] in which the tribunal stated that the funding has no impact on the arbitral proceeding.[581] Sometimes, however, voluntary disclosure can be misunderstood by the opposing side.[582] In most cases, however,

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[578] *See* CIETAC Arbitration Rules, art. 27.

[579] *See* International Centre for Settlement of Investment Disputes (ICSID) Secretariat, *Working Draft #3: Proposals for Amendment of the ICSID Rules*, at 41, 91 (Aug. 2019).

[580] *See* Oxus Gold plc v. Republic of Uzb., UN Comm'n on Int'l Trade Law, Final Award (Dec. 17, 2015).

[581] *See id.* para. 127 ("It is undisputed that Claimant is being assisted by a third party funder in this arbitration proceeding. The Arbitral Tribunal has mentioned this fact in its Procedural Order Nos. 6 and 7. However, this fact has no impact on this arbitration proceeding.").

[582] *See* Jonas von Goeler, *Third-Party Funding in International Arbitration and Its Impact*

the arbitral tribunal has ordered disclosure of the identity of the third-party funder and — more rarely — may also order disclosure of the terms of the funding arrangement. For example, a dispute regarding termination of the funding arrangement in the ICSID case *S&T Oil Equipment & Machinery Ltd v Romania* was litigated in the U.S. courts, which required disclosure of the terms funding arrangement in court litigation.[583] As a result of this dispute over the funding arrangement, the funder, Juridica, ceased paying S&T Oil's fees and costs in the ICSID case, and the ICSID tribunal ultimately terminated the proceedings due to this nonpayment.[584] In this case, the funding agreement was in dispute, so disclosure of its terms was appropriate.

In most cases, however, the funding agreement is not in dispute, so disclosure of its terms is not appropriate. For example, in the ICSID case *EuroGas Inc. and Belmont Resources Inc. v. Slovak Republic*, the tribunal ordered the claimant to reveal the identity of its third-party funder for the purposes of checking for arbitrator conflicts of interest, but did not require the claimant to disclose any of the terms of the funding arrangement.[585] In that case, the claimant had previously voluntarily disclosed that it was funded by a Luxembourg-based funder, but the claimant did not disclose the identity of that funder until ordered to do so by the tribunal.

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on Procedure, 127 (citing X v. Y and Z, ICC Case, Procedural Order of 3 August 2012, published in Pinsolle, CAH. ARB. (2013), 399-416) ("In the ICC case *X v. Y and Z*, for example, the claimant transferred a litigation funding agreement to the respondents without further explanation, leading counsel for the respondents to the assumption that '[t]his agreement was sent maybe by mistake'.").

[583] *See* S&T Oil Equipment & Machinery, Ltd, et al v. Juridica Investments Limited, et al, 456 Fed. Appx. 481, 2012 WL 2842, (5th Cir., 5 Jan. 2012) (requiring disclosure of funding arrangement to resolve a dispute between S&T and Juridica regarding termination of the third-party funding provided for the *ICSID case S&T Oil Equipment & Machinery Ltd v. Romania, ICSID* Case No ARB/07/13, Order to Discontinue Proceedings (16 July 2010)); Bernardo M. Cremades Jr., *Third Party Litigation Funding: Investing in Arbitration* (2011) 8 TRANSNATIONAL DISPUTE MANAGEMENT 12–15 (discussing these two S&T cases); Nate Raymond, *Litigation funding gone wrong*, THE AMERICAN LAWYER, (25 Apr. 2011), available at http://www.law.com/jsp/tal/PubArticleTAL.jsp?id=1202492845664&slreturn=1law.com (discussing the U.S. Fifth Circuit case, *S&T v. Juridica*).

[584] *See supra* note 562.

[585] *See* EuroGas, Inc. and Belmont Resources, Inc. v. Slovak Republic, ICSID Case No ARB/14/14, Transcript of the First Session and Hearing on Provisional Measures, 145 (Mar. 17, 2015) ("We think that the Claimants should disclose the identity of the third-party funder, and that third-party funder will have the normal obligations of confidentiality.").

Muhammet Çap & Sehil Inşaat Endustri ve Ticaret Ltd Sti v. Turkmenistan, an ICSID case, provides a rare example of a tribunal ordering a claimant to disclose both the identity of the funder and the terms of the funding arrangement.[586] In doing so, the tribunal invoked its "inherent powers to make orders of the nature requested where necessary to preserve the rights of the parties and the integrity of the process." In April 2014, Turkmenistan had requested the tribunal to order the claimant to disclose whether it had engaged the services of a third-party funder, as well as the terms of that arrangement.[587] In Procedural Order No. 2, the tribunal refused the request and listed several reasons why a tribunal could justifiably order disclosure of third-party funding, such as "avoid[ing] a conflict of interest," "transparency," "identify[ing] the true party to the case," cost allocation, and protecting confidential information.[588]

One year later, Turkmenistan renewed its request for such disclosure to ensure that there were no conflicts of interests with the arbitrators or counsel in the case and to check whether the claimants were "still the actual owners of the claims in this arbitration."[589] In order to bolster its renewed request, Turkmenistan also cited the newly enacted General Standard 7(a) and the Explanation to General Standard 7(a) of the International Bar Association (IBA) Guidelines on Conflicts of Interest in International Arbitration, which took effect in October 2014.[590] Turkmenistan also stated that it was considering applying for security for costs in the case due to the presence of the third-party funder.[591]

In Procedural Order No. 3, the tribunal decided to grant Turkmenistan's renewed request in order to "ensur[e] the integrity of the proceedings and to determine whether any of the arbitrators are affected by the existence of a third-party funder" and because the claimant did not pay an order for costs in another related case.[592] It is important to note that the tribunal did not specify in its

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[586] *See* Muhammet Çap & Sehil Inşaat Endustri ve Ticaret Ltd Sti v. Turkm., ICSID Case No. ARB/12/6, Procedural Order No. 3 (June 12, 2015).
[587] *Id*. para. 1.
[588] Muhammet Cap & Sehil Insaat Endustri ve Ticaret Ltd. Sti. v. Turkm., ICSID Case No. ARB/12/6, Decision on Jurisdiction, para. 50 (Feb. 13, 2015) (quoting Procedural Order No. 2).
[589] *See* Muhammet Çap & Sehil Inşaat Endustri ve Ticaret Ltd Sti v. Turkm., ICSID Case No ARB/12/6, Procedural Order No 3. para. 2 (June 12, 2015).
[590] *Id*. para 2.
[591] *Id*. para 2.
[592] *Id*. paras. 9-12. The other related case in which the claimant had not paid the costs ordered was Kılıç İnşaat İthalat İhracat Sanayi ve Ticaret Anonim Şirketi v. Turkm., ICSID

procedural order which of the terms of the funding arrangement were required to be disclosed and which could stay confidential.[593] This creates uncertainty regarding whether such disclosure may unfairly disadvantage the disclosing party or unfairly advantage the party receiving the information.

Similarly, in the PCA case *South American Silver v. Bolivia*, Bolivia "request[ed] the Tribunal to order the Claimant to 'disclose the identity of the funder of this arbitration, as well as the terms of the funding agreement signed with him.'"[594] As in the *Muhammet Cap* case, it would appear that the parent company of the claimant had earlier voluntarily disclosed the existence of the third-party funding, but not the identity of the funder or the terms of the agreement.[595] Like Turkmenistan, Bolivia argued that it was seeking this disclosure and security for costs due to the economic difficulties of the claimant coupled with the existence of third-party funding.[596] Bolivia also cited the 2014 IBA Guidelines provision "that third-party funders should be equated with the funded party to verify the existence of conflict of interests, and that the funded party is obliged to disclose any relationship that exists between her (including third-party funders) and the arbitrators."[597] South American Silver (SAS) in its reply to Bolivia's request agreed to disclose the name of its funder but noted that "the terms of SAS's funding agreement are irrelevant to the issues in dispute in this arbitration and that the terms of that agreement are confidential, commercially sensitive, and that SAS and the funder would incur prejudice if the Tribunal ordered SAS to disclose the terms of the funding agreement."[598] With respect to Bolivia's application for security for costs, the tribunal adopted the standard articulated by the majority of the tribunal in *RSM v. Saint Lucia* and *EuroGas v. Slovak Republic* that the "the mere existence of a third-party funder is not an exceptional situation justifying security for costs."[599] In the end, the tribunal decided to order disclosure of the

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Case No. ARB/10/1.

[593] *See* Jean-Christophe Honlet, *Recent Decisions on Third-Party Funding in Investment Arbitration*, 30 ICSID REV., no. 3, 2015, at 699-712.

[594] South American Silver Ltd. v. Plurinational State of Bol., PCA Case No. 2013-15, Procedural Order No. 10, para. 13 (Jan. 11, 2016).

[595] *Id.* para. 25.

[596] *Id.* para. 25.

[597] *Id.* para. 29.

[598] South American Silver Ltd. v. Plurinational State of Bol., PCA Case No. 2013-15, Claimant Opposition to Respondent Request for Cautio Judicatum Solvi and Disclosure of Information, paras. 38, 40 (Dec. 14, 2015).

[599] *Id.* para. 74 (citing EuroGas, Inc. & Belmont Resources, Inc. v. Slovak Republic, ICSID

name of the funder "for purposes of transparency, and given the position of the Parties" but determined that there was no basis to order disclosure of the terms of the funding arrangement.[600]

Domestic Courts

In terms of relevant domestic court disclosure standards, the courts of the United Kingdom have experienced an increase in cases related to the disclosure of third-party funding in domestic litigation as well as international arbitration. Specifically, with respect to disclosure of third-party funding in domestic litigation relating to an international dispute, the English High Court in *Arroyo & Ors v. BP Exploration Co (Colombia) Ltd.* took the view that parties with funding arrangements…are entitled to be treated in the same way as other parties to litigation…. All that the Existence of ATE [after-the-event insurance] arrangements adds to the case is that it gives these Claimants access to a fund… which they would otherwise not have. But there is no more reason for the Claimants to give disclosure of the details of their insurance fund in an ATE case than there would be for them to give disclosure of the funds in their savings accounts, or the funds available from non-ATE insurers.[601]

Thus, it appears that the English High Court applied the general rule that a party is not required to disclose its funding sources and declined to create an exception for third-party funding arrangements, such as after-the-event insurance (ATE).

United States courts have not yet had the opportunity to address third-party funding in an international arbitration, although there are numerous examples of domestic courts addressing litigation funding in purely domestic cases.[602]

Treaties

At the time of this writing, it appears that only one ratified treaty addresses disclosure of third-party funding. The Comprehensive Economic and Trade

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Case No. ARB/14/14, Procedural Order No. 3 – Decision on Requests for Provisional Measures, para. 123 (June 23, 2015).

[600] *Id*. paras. 79, 80, 84.

[601] Arroyo & Ors v. BP Exploration Co. (Colombia) [2010] EWHC (QB) Case No. HQ08X00328, [48], [52].

[602] *See* LISA BENCH NIEUWVELD & VICTORIA SHANNON SAHANI, THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION (Wolters Kluwer, 2nd ed., 2017) (presenting a 50-state survey of third-party funding laws in the United States).

Agreement (CETA), ratified by Canada and the European Union, contains provisions defining third-party funding and requiring that the funded party disclose to tribunal and the opposing party the name and address of the third-party funder at the time of the submission of the claim or at the time the funding agreement is concluded, whichever is sooner.[603] With respect to proposed treaties, a similar provision appears in the EU-Singapore Investment Protection Agreement, which has not yet been ratified.[604] In addition, the European Commission (EC) has proposed including provisions nearly identical to the CETA provisions in the Transatlantic Trade and Investment Partnership (T-TIP), which has not yet been concluded.[605] In addition, the current draft of the EU-Vietnam Investment Protection Agreement, Ch. 8, Ch. II, Sec. 3, Art. 2, contains a similar definition of third-party funding as "any funding provided by a natural or juridical person who is not a party to the dispute but who enters into an agreement with a disputing party in order to finance part or all of the cost of the proceedings in return for a remuneration dependent on the outcome of the dispute or in the form of a donation or grant."[606] Art. 11 provides for a similar disclosure requirement as CETA and the EC's proposed T-TIP provisions, except it also adds a required disclosure regarding the "nature of the funding arrangement."[607] It also requires that "the Tribunal shall take into account whether there is third-party funding" when making decisions regarding costs and security for costs.[608] The text of the EU-Vietnam Free Trade Agreement was published after the negotiations concluded on 1 February 2016, but the treaty has not yet been ratified.[609]

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[603] *See Comprehensive Economic and Trade Agreement*, arts. 8.1, 8.26 (Sept. 14, 2016), http://data.consilium.europa.eu/doc/document/ST-10973-2016-INIT/en/pdf

[604] *See EU-Singapore Investment Protection Agreement*, art. 3.8, https://eur-lex.europa.eu/resource.html?uri=cellar:55d54e18-42e0-11e8-b5fe-01aa75ed71a1.0002.02/DOC_2&format=PDF#page=29

[605] *See* European Comm'n, Draft, *Chapter II, in Transatlantic Trade and Investment Partnership*, arts. 1, 8, http://trade.ec.europa.eu/doclib/docs/2015/september/tradoc_153807.pdf

[606] *See EU-Vietnam Investment Protection Agreement*, ch. 8, ch. II, § 3, art 2, https://trade.ec.europa.eu/doclib/docs/2018/september/tradoc_157394.pdf

[607] *Id.* ch. 8, ch. II, § 3, art. 11.

[608] *Id.*

[609] *See Vietnam*, EUR. COMM'N, http://ec.europa.eu/trade/policy/countries-and-regions/countries/vietnam/ ("The legal review of the negotiated text is currently on-going and will be followed by translation into the EU's official languages and Vietnamese. The Commission will then present a proposal to the Council of Ministers for approval of the agreement and ratification by the European Parliament.").

National Legislation

With respect to national statutes, on 10 January 2017, Singapore's parliament passed the Civil Law (Amendment) Bill No. 38/2016 permitting third-party funding in international arbitrations seated in Singapore as well as related court and mediation proceedings.[610] The bill abolishes the torts of champerty and maintenance but preserves the defense that a contract is against public policy or illegal under Singapore law. The bill expressly provides for an exception for third-party funding agreements, expressly stating that such agreements are not contrary to public policy or illegal. Courts will continue to have the power to inquire into the nature of the third-party funding, and future amendments to Singapore's Legal Profession (Professional Conduct) will require lawyers to disclose the existence of their clients' third-party funding arrangements and will prohibit lawyers from accepting commissions or referral fees from third-party funders.

Similarly, on 11 January 2017, in Hong Kong, the Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Bill 2016 was introduced into the Legislative Council for Second Reading.[611]This bill legalized third-party funding in international arbitrations and mediations seated in Hong Kong. Rather than abolishing the torts of maintenance and champerty, the bill instead carves out an exception for third-party funding of arbitration only, but not for domestic litigation. Like Singapore, the bill preserves the defense that a contract is against public policy or illegal under Hong Kong law. Disclosure of the existence of the funding and identity of the funder is required. The Bill also provides that an "authorized body" appointed by the Secretary of Justice will issue a "code of

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[610] *See* Civil Law (Amendment) Bill No. 38/2016; *Key Bills Passed in Singapore, as Hong Kong Moves Towards Funding,* GLOB. ARB. REV. (Jan. 11, 2017), http://globalarbitrationreview.com/article/1079959/key-bills-passed-in-singapore-as-hong-kong-moves-towards-funding; *The Singapore Bills: a Detailed Look,* GLOB. ARB. REV. (Jan. 12, 2017), http://globalarbitrationreview.com/article/1079960/the-singapore-bills-a-detailed-look

[611] *See* Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Bill (2016), (proposed legislation), http://www.gld.gov.hk/egazette/pdf/20162052/es32016205213.pdf?cid=social_20170106_69214806&adbid=817404762849046528&adbpl=tw&adbpr=190964959%20; Press Release, Department of Justice, The Government of the Hong Kong Special Administrative Region, Third Party Funding of Arbitration: Amendments Proposed for Arbitration Ordinance and Mediation Ordinance (Dec. 28, 2016), https://www.doj.gov.hk/eng/public/pr/20161228_pr2.html; *Key Bills Passed in Singapore, as Hong Kong Moves Towards Funding,* GLOB. ARB. REV. (Jan. 11, 2017), https://globalarbitrationreview.com/article/1079959/key-bills-passed-in-singapore-as-hong-kong-moves-towards-funding

practice," after "consult[ing] the public," for third-party funders operating in Hong Kong, describes some of the provisions that would be included in this code of practice, and provides for a limited enforcement mechanism for "non-compliance with the code of practice." The Hong Kong government published its highly anticipated "Code of Practice of Third Party Funding of Arbitration" on 7 December 2018, and the code took effect on February 1, 2019.[612] Among other provisions, the code requires that a funder must remind the funded party of its obligation to disclose information about the funding.

It is likely that requests for disclosure relating to third-party funding arrangements in international commercial and investment arbitration will become more prevalent, and tribunals will be more likely to be granted such requests.[613] However, it is important to balance the need for transparency with the potential for one party to become advantaged or disadvantaged in the arbitration as a direct result of the information disclosed.[614] In addition, the non-funded party may be tempted to present dilatory requests or arguments to the tribunal following the disclosure.[615] Tribunals must be vigilant in order to ensure that the disclosure of third-party funding does not influence the flow or tone of the arbitral proceedings.

Although it did not directly address international arbitration, in January 2017, the United States District Court for the Northern District of California — the district in which many Silicon Valley-related disputes are heard — became the first U.S. federal court to adopt a rule requiring attorneys to disclose whether a third-party funder is involved in class actions.[616] The rule was later reworded to extend to all cases filed in the Northern District of California.[617] In April 2018, the

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[612] Press Release, Government of the Hong Kong Special Administrative Region, Code of Practice for Third Party Funding of Arbitration Issued (Dec. 7, 2018), https://www.info.gov.hk/gia/general/201812/07/P2018120700601.htm; Code of Practice of Third-Party Funding of Arbitration (Dec. 7, 2018), https://gia.info.gov.hk/general/201812/07/P2018120700601_299064_1_1544169372716.pdf

[613] *See generally* Jean-Christophe Honlet, *Recent decisions on third-party funding in investment arbitration*, 30 ICSID REV., no. 3, 2015, at 699-712.

[614] *Id.*

[615] *Id.*

[616] *See* Ben Hancock, *Northern District, First in Nation, Mandates Disclosure of Third-Party Funding in Class Actions*, RECORDER, (Jan. 23, 2017, 10:07 PM), http://www.therecorder.com/home/id=1202777487488/Northern-District-First-in-Nation-Mandates-Disclosure-of-ThirdParty-Funding-in-Class-Actions

[617] *See* N.D. Cal. Civ. Ct. R. 3-15, https://www.cand.uscourts.gov/localrules/civil

State of Wisconsin became the first state (rather than a single court) to pass legislation that requires disclosure of third-party funding in all cases in Wisconsin courts.[618] Other states will likely follow suit. These examples chart a new path toward greater disclosure of the participation of third-party funders in domestic litigation, which other courts or arbitral institutions may choose to follow in the future.

DISCLOSURE-RELATED ROLES FOR THIRD-PARTY FUNDERS IN INTERNATIONAL ARBITRATION

Third-party funders serve several distinct roles in international arbitration that affect disclosure requirements under the applicable sources of authority, discussed earlier in this article. Those roles include serving as custodians of confidential and privileged information; preventing arbitrator conflicts of interest, thereby ensuring the legitimacy of the international arbitration system; and investing in claims for motivations other than profit-making.

NONDISCLOSURE: FUNDERS AS CUSTODIANS OF CONFIDENTIAL AND PRIVILEGED INFORMATION

Third-party funders receive confidential and privileged information about the funded party's case and are involved in maintaining the preexisting regime of non-disclosure of such confidential and privileged information. In this way, third-party funders could be said to be custodians of confidential and privileged information during the arbitration proceedings. Funders receive information from parties or law firms that they choose to fund, and those entities trust that the funder will maintain the secrecy of that information.[619] Funders also receive key information about the dispute-resolution system (both litigation and arbitration) and about particular cases from the parties or law firms that seek their services but whom they choose *not* to finance.[620] Funders ask potential clients to share a lot of

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[618] *See* WIS. STAT. § 804.01(2) (2018); John Freund, *Wisconsin Becomes First State to Require Disclosure of Third Party Legal Funding*, LITIG. FIN. J. (Apr. 4, 2018) (on file with author).
[619] *See* Gary Shaw, *Third-Party Funding in Investment Arbitration: How Non-Disclosure Can Cause Harm for the Sake of Profit*, 33 ARB, INT'L, no. 1, 2017, at 118.
[620] *See* Victoria Shannon Sahani, *The Impact of Third-Party Funders on the Parties They Decline to Finance,* KLUWER ARB. BLOG (Jul. 6, 2015), http://kluwerarbitrationblog.com/blog/2015/07/06/the-impact-of-third-party-funders-on-the-parties-they-decline-to-finance/

information about themselves and about their cases in order for the funder to decide whether to fund the party's case. Parties not only may share the merits of the cases with funders, but also they often will share their internal financial data and documents, trade secrets, business practices, governmental communications, and other information that may otherwise be protected by applicable privilege rules in their home jurisdictions.[621] Law firms will most certainly have to share information about their internal finances as well as information about the financial status — and perhaps even the likelihood of winning on the merits — of the cases the law firm is handling in its portfolio of cases.

With respect to individual parties, funders do not accept the vast majority of potential clients that cross their desks; the average acceptance rate for most funders hovers between 5% and 20%, with some funders accepting as few as 1% of the potential clients seeking funding.[622] This means that 80% to 99% of the parties that share information with funders will *not* receive funding from that funder, and those parties are trusting that those funders and their confidentiality agreements will ensure that the information will continue to be confidential and privileged beyond the encounter.[623] The estimated acceptance rate for law firm financing arrangements is unknown, but it is safe to presume that law firms that are declined financing probably have similar expectations and agreements with funders regarding confidentiality and privileges. Due to the large amount of sensitive information shared with funders by funded and non-funded entities alike, third-party funders have in some sense become de facto custodians of confidential information in international arbitration. The world will likely never know truly how much confidential and privileged information they shepherd.

So far, funders have done an exceptional job in maintaining the confidentiality of their clients' information and protecting the evidentiary privileges that their

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[621] *See* Gary Shaw, *Third-Party Funding in Investment Arbitration: How Non-Disclosure Can Cause Harm for the Sake of Profit*, 33 ARB, INT'L, no. 1, 2017, at 118.
[622] *See* Victoria Shannon Sahani, *The Impact of Third-Party Funders on the Parties They Decline to Finance*, KLUWER ARB. BLOG (Jul. 6, 2015), http://kluwerarbitrationblog.com/blog/2015/07/06/the-impact-of-third-party-funders-on-the-parties-they-decline-to-finance/; Gary Shaw, *Third-Party Funding in Investment Arbitration: How Non-Disclosure Can Cause Harm for the Sake of Profit*, 33 ARB, INT'L, no. 1, 2017, at 112.
[623] *See* Victoria Shannon Sahani, *The Impact of Third-Party Funders on the Parties They Decline to Finance*, KLUWER ARB. BLOG (Jul. 6, 2015), http://kluwerarbitrationblog.com/blog/2015/07/06/the-impact-of-third-party-funders-on-the-parties-they-decline-to-finance/; Miller UK Ltd. v. Caterpillar, Inc., 17 F. Supp. 3d 711 (N.D. Ill. 2014).

clients may hold. This author has yet to hear of an unintended leak or disclosure of confidential or privileged information by a third-party funder. To maintain this level of information security, it is a best practice of the industry that third-party funders enter into a confidentiality agreement with the client or law firm at the outset of the financing.[624] Some third-party funders take the extra step of employing a law firm — separate and apart from the law firm representing the party in the case — to review and handle confidential or privileged information in order to help preserve any privileges or other evidentiary protections that may exist. The funder's law firm would interface with the client's law firm (or the client itself, if the client is a law firm); thus, the circle of confidentiality and privilege remains intact. Funders typically only pay the high cost of employing two separate law firms — the client's law firm as well as its own law firm — in cases where the claimed dollar amount is high enough to justify such expensive measures to protect evidentiary privileges or where the information is sensitive enough to justify such expensive measures. As an example, an arbitration involving a patent or trade secret infringement claim typically involves both high dollar amounts and sensitive client information, so employing two law firms may be justified.[625]

A few funders have advisory boards consisting of prominent attorneys and arbitrators to help them choose which cases to fund.[626] In those cases, the advice that the funders are seeking regarding whether the case should be funded relies upon the expertise of those heavily invested in the field of arbitration.[627] The funder must then expand the confidentiality and privilege arrangement to include

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[624] *See generally, Chapter 5: Privilege and Professional Secrecy, in* TASK FORCE REPORT, *supra* note 4 (discussing best practices and principles with respect to preserving client confidentiality during a third-party funding arrangement); Miller UK Ltd. v. Caterpillar, Inc., 17 F. Supp. 3d 711 (N.D. Ill. 2014) (discussing the efficacy of confidentiality agreements between third-party funders and clients in U.S. federal courts); Gary Shaw, *Third-Party Funding in Investment Arbitration: How Non-Disclosure Can Cause Harm for the Sake of Profit*, 33 ARB, INT'L, no. 1, 2017, at 109.

[625] *See* Gary Shaw, *Third-Party Funding in Investment Arbitration: How Non-Disclosure Can Cause Harm for the Sake of Profit*, 33 ARB, INT'L, no. 1, 2017, at 118.

[626] *See* Sherina Petit, James Rogers & Cara Dowling, *Third-Party Funding in Arbitration - the Funders' Perspective: A Q&A with Woodsford Litigation Funding, Harbour Litigation Founding and Burford Capital*, NORTON ROSE FULBRIGHT INT'L ARB. REP., no. 7, Sept. 2016, at 11 (on file with author) ("Parties may even benefit from this further analysis of the merits of their case (in addition to that already conducted by their legal advisors) — particularly where funders have seasoned arbitrators on their review boards.") (parentheses in original).

[627] *See, e.g.*, Leo Szolnoki, *Beechey To Advise Third-Party Funder*, GLOB. ARB. REV. (Nov. 5, 2013), http://globalarbitrationreview.com/news/article/32028/.

members of its advisory board, who then become part of the "circle of trust," as a certain famous movie character might say.[628] On the one hand, one could argue that the more people who know a secret, the less of a secret it becomes. On the other hand, given the extent of information-sharing with third-party funders, the information security in the third-party funding industry has thus far been impressively nonporous, which is a credit to third-party funders themselves. No doubt they all have a shared vested interest in maintaining the necessary veil of confidentiality and privileges, or else their business models will undoubtedly start to crumble.

There is a potential dark side to funders having access to this much confidential information, however. It is possible that a funder may use confidential information against a party in a subsequent arbitration, even without necessarily waiving any privileges or violating any confidentiality agreements.[629] While attorney ethics rules prohibit such use, there is no corresponding prohibition on funders themselves.[630] As a best practice, the confidentiality agreement between the funder and the funded party should include a provision prohibiting the funder from using the client's confidential information in any way beyond the funding arrangement itself. In addition, parties seeking funding should enter into a confidentiality agreement with a potential funder before sharing any information with that funder, including such a provision prohibiting the funder from using the client's confidential information in any way, even if no funding relationship ensues.

PROACTIVE DISCLOSURE: PREVENTING ARBITRATOR CONFLICTS OF INTEREST

While some funders may negotiate funding arrangements that allow them to influence or control the strategy or settlement of the funded party,[631] the clear

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[628] The movies MEET THE PARENTS (2000) and MEET THE FOCKERS (2004) contain various references to the "circle of trust," mostly made by Robert DeNiro's character, Jack Byrnes.

[629] *See* Gary Shaw, *Third-Party Funding in Investment Arbitration: How Non-Disclosure Can Cause Harm for the Sake of Profit*, 33 ARB, INT'L, no. 1, 2017, at 119.

[630] *Id.* (indicating that there is no prohibition on a third-party funder using information to the definition of a former client); *cf.* MODEL RULES OF PROF'L CONDUCT r. 1.9(c)(1) (AM. BAR ASS'N 2016) (prohibiting a lawyer from using a former client's information to the "disadvantage" of that former client).

[631] *See* Gary Shaw, *Third-Party Funding in Investment Arbitration: How Non-Disclosure Can Cause Harm for the Sake of Profit*, 33 ARB, INT'L, no. 1, 2017, at 115.

majority of funders know that maintaining an arms-length distance from the day-to-day management of the dispute is the best way to avoid conflicts of interest or other procedural indiscretions that may adversely affect the enforceability of the eventual arbitral award. Nevertheless, procedural problems can spawn from the mere revelation that a funder is involved in a case. For example, the mere presence of a funder could potentially create conflicts of interest for arbitrators and counsel.[632] This is particularly true in investment arbitration in which the legitimacy of the process is sometimes challenged by states and outsiders.[633]

The conflict of interest problem is more prevalent in arbitration than in litigation because of the nature of the role of the decision-maker. The "double hat" problem in international arbitration generally — that is, arbitrators serving as counsel and vice versa — can easily create conflicts of interest when funders are financing more than one case involving attorneys or arbitrators from the same law firm or chambers.[634] It is important to note that no arbitration rules impose disclosure obligations directly on third-party funders, even if they discover conflicts of interest during the due diligence process.[635] As mentioned earlier in this article, the existing disclosure rules all put the disclosure obligations on the parties, the arbitrators, and/or the legal counsel in the case; the rules do not require third-party funders to participate directly in disclosure. In contrast, in litigation, judges do not serve as legal counsel or knowingly invest in disputes. In theory, a financial conflict of interest could arise, however, if a judge owns equity in a publicly traded litigation funder, for example, in a retirement account or stock

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[632] *See id.* at 116.

[633] *See id.* at 115.

[634] For an explanation of the double-hat problem, *see* Dennis H. Hranitzky & Eduardo Silva Romero, *The 'Double Hat' Debate in International Arbitration: Should Advocates and Arbitrators Be in Separate Bars?*, N.Y.L.J. (June 14, 2010), https://www.dechert.com/content/dam/dechert%20files/publication/2010/6/the-double-hat-debate-in-international-arbitration/070101031Dechert.pdf) ("It is commonplace in international arbitration, as in most domestic arbitration in the United States, for experienced practitioners who actively represent parties before arbitral tribunals to serve as arbitrators in other cases. Indeed, it is not unusual for an individual to represent a party in an arbitration administered by one of the larger international institutions . . . and at the same time serve as an arbitrator in another matter administered by the same institution. In recent years, this practice has come under fire from practitioners and parties alike, resulting in calls for new rules prohibiting counsel who represent parties in arbitrations from serving as arbitrators in other cases.").

[635] Gary Shaw, *Third-Party Funding in Investment Arbitration: How Non-Disclosure Can Cause Harm for the Sake of Profit*, 33 ARB, INT'L, no. 1, 2017, at 117.

portfolio. There have been no examples of this, to this author's knowledge, and in reality, judges are typically overly cautious to avoid creating financial conflicts of interest; therefore, it should be obvious to judges that they should not knowingly invest in litigation funders.

Even if the funder is not directly trying to control or influence the legal representation or the choice of arbitrator, there may be other ways in which the funder's participation may create conflicts of interest or influence the process. For example, funders may affect the timing and terms of settlement.[636] In addition, there has been at least one case involving a question of arbitrator bias in favor of or against a party's use of third-party funding. The claimant in *RSM Production Corporation v. Saint Lucia* challenged arbitrator Dr. Gavin Griffith due to his controversial statements regarding third-party funding in his Assenting Opinion.[637] The claimant's principal grounds for the challenge were as follows:

The description of third-party funders as "mercantile adventurers" and the association with "gambling" and the "gambler's Nirvana: Heads I win and Tails I do not lose" are, in Claimant's view, radical in tone and negative and prejudge the question whether a funded claimant will comply with a costs award. Additionally, Claimant derives from Dr. Griffith's determinations that his alleged bias against the funders extends to Claimant as the funded party as well. Claimant contends that the language used by Dr. Griffith cannot be qualified as a neutral discussion of the issues or a mere rhetorical emphasis.[638]

The other two arbitrators, Prof. Dr. Siegfried H. Elsing (President) and Judge Edward W. Nottingham (Co-arbitrator), rejected the challenge and articulated the following reasoning:

The expressions used by Dr. Griffith in his Assenting Reasons, such as "gambling," "adventurers" and the reference to the "gambler's Nirvana" are strong and figurative metaphors. However, in our view, these expressions primarily serve the purpose of clarifying and emphasizing the point Dr. Griffith purports to make, namely the paramount importance, in his opinion, of third-party funding of a

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[636] *See* Gary Shaw, *Third-Party Funding in Investment Arbitration: How Non-Disclosure Can Cause Harm for the Sake of Profit*, 33 Arb, Int'l, no. 1, 2017, at 115.

[637] *See* RSM Production Corp. v. St. Lucia, ICSID Case No ARB/12/10, Decision on Claimant's Proposal for the Disqualification of Dr. Gavan Griffith QC (Oct. 23, 2014), IIC 662 (2014).

[638] *Id.* ¶ 42.

> party in connection with a request for security for costs. We do not regard it to be established that these terms reveal any underlying bias against third-party funders in general or Claimant in particular. The means of expressing a point of view or articulating an argument may vary from one arbitrator to another, and different arbitrators possess varied characteristics, including their habits of drafting decisions and the wording used. As long as such wording does not clearly reveal any preference for either party, it cannot serve as a ground for a challenge.... As we require an objective standard to be met, Claimant needs to establish facts indicating Dr. Griffith's lack of impartiality. However, in this case, the facts presented are that Dr. Griffith issued his Assenting Reasons with the contents as described by Claimant. These facts, however, are as such not sufficient to constitute a lack of impartiality. The underlying arguments, as presented by Dr. Griffith and the wording, in our view, do not cast reasonable doubt upon Dr. Griffith's capacity to issue an independent and impartial judgment in the present arbitration.[639]

While this case is fascinating, this fact scenario is not the norm, because most arbitrators do not express strong opinions regarding third-party funding in their written awards or procedural orders.[640]

Other procedural mechanisms may be triggered by the presence of a funder. For example, the mere existence of funding may lead some opposing parties to file an application for security for costs, which is inappropriate absent additional circumstances suggesting that the party is impecunious independent of the funder.[641] Thus, the funder's participation can influence the assumptions that the opposing party or the arbitrators may have about the financial situation of the funded party. Increasingly, however, many solvent parties are using third-party funding as a risk allocation tool in their business strategy, so arbitrators will

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[639] *See Id.* paras. 87, 90.

[640] The most recent public information regarding the status of this underlying merits case is that, on 21 November 2016, RSM applied for annulment of the merits award, which has not been made public. *See* RSM Production Corp. v. St. Lucia, ICSID Case No ARB/12/10, Procedural History (Oct. 23, 2014), IIC 662 (2014).

[641] *See* Alan Redfern & Sam O'Leary, *International Arbitration to Embrace Security for Costs*, 32 ARB. INT'L, no. 3, 2016, at 407-408; Gary Shaw, *Third-Party Funding in Investment Arbitration: How Non-Disclosure Can Cause Harm for the Sake of Profit*, 33 ARB, INT'L, no. 1, 2017, at 115.

usually not agree with a party's argument that a funded party is assumed to be a fiscally challenged party who should be required to post security for costs.[642]

Furthermore, arbitrators do not have the power to make orders directly against third-party funders, because the third-party funders are not signatories to the arbitral agreement.[643] However, most jurisdictions allow courts to exercise jurisdiction over non-parties in certain circumstances — such as issuing a subpoena to a witness — so an arbitral tribunal may consider seeking the assistance of a court if it decides to make an order against a funder. However, the court will likely be reluctant to issue such an order against a funder except in an extreme or unusual circumstance.

It has been suggested that a funder could attempt to fund both sides of a dispute in order to hedge its investment or gain confidential information about the parties for use in a future arbitration.[644] Such a practice would be viewed by the international arbitration community as clearly unethical under customary international law norms — despite the lack of rules on such a practice — and this author is not aware of any example of this occurring in any case. By comparison, attorney ethics rules clearly prohibit attorneys from representing both sides of a dispute.[645]

Finally, as mentioned at the outset, funders have an overarching interest in ensuring the integrity of the procedure and the enforceability of the arbitral award, without which the funder will not be paid. Disclosure rules all help to ensure the integrity of the resulting award in the eyes of the court that might be asked to enforce the award.

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[642] *See* Sherina Petit, James Rogers & Cara Dowling, *Third-Party Funding in Arbitration - the Funders' Perspective: A Q&A with Woodsford Litigation Funding, Harbour Litigation Founding and Burford Capital*, NORTON ROSE FULBRIGHT INT'L ARB. REP., no. 7, Sept. 2016, at 3 (on file with author).

[643] *See* Alan Redfern & Sam O'Leary, *International Arbitration to Embrace Security for Costs*, 32 ARB. INT'L, no. 3, 2016, at 409.

[644] *See* Gary Shaw, *Third-Party Funding in Investment Arbitration: How Non-Disclosure Can Cause Harm for the Sake of Profit*, 33 ARB, INT'L, no. 1, 2017, at 119-20; Victoria Shannon Sahani, *Judging Third-Party Funding*, 63 UCLA L. REV. 388, 427 n.206 (2016).

[645] *See* MODEL RULES OF PROF'L CONDUCT r. 1.7(a) (AM. BAR ASS'N 2016). In that respect, disputes are treated very differently than transactions. For example, many jurisdictions allow an attorney to represent parties on opposite sides of a routine transaction, such as the sale of real estate or an uncontested divorce.

PUBLIC DISCLOSURE: THE RISING INFLUENCE OF OUTCOME-MOTIVATED FUNDERS

While the vast majority of funders in international arbitration are for-profit, there are also many funders for which financial profit is not their primary motivation. Other motivations may include regulatory changes, precedent-setting, industry rule-making, or even vengeance. This nascent category of funders may be termed "not-for-profit funders"[646] or "ideological fund[ers]"[647] or outcome-motivated funders.[648] These funders are motivated to bring about a certain outcome in the case or a change in the law, rather than motivated by making a profit. Unlike traditional for-profit funders, outcome-motivated funders are often very keen to make their presence known to the tribunal, the opposing side, and sometimes even the general public or media, in the case, in hopes that the revelation will sway the outcome of the case.

There are many questions about such outcome-motivated funding that remain to be answered. Potential justifications for ordering disclosure of such funders may be similar to the justifications for disclosure of traditional funding, but there are some unique challenges that have yet to be fully uncovered and analyzed. Outcome-motivated funding may become more prevalent for respondents, because a return on investment is not required for this type of funding to be considered successful. For example, the Bloomberg Foundation and its Campaign

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[646] *See, e.g.*, Eric De Brabandere & Julia Lepeltak, *Third-Party Funding in International Investment Arbitration*, 27 ICSID REV., no. 2, 2012, at 379-98.

[647] *See, e.g.*, Eugene Kontorovich, Opinion, *Peter Thiel's funding of Hulk Hogan-Gawker litigation should not raise concerns*, WASH. POST, May 26, 2016, https://www.washingtonpost.com/news/volokh-conspiracy/wp/2016/05/26/peter-thiels-funding-of-hulk-hogan-gawker-litigation-should-not-raise-concerns/?noredirect=on&utm_term=.ff0b69feadb4 ("Anyone who donates to the ACLU or a Legal Aid fund is basically underwriting third-party litigation. Most recently, private profit-motivated litigation finance has emerged as an industry in its own right, unburdened by any concern over the old common law rules . . . . By current standards, Thiel's funding should raise no eyebrows — unless one also wants to revisit public interest litigation, class actions and contingent fees. Critics of Thiel's role in the Gawker case argue that it is particularly inappropriate because they think he is motivated by "revenge" over the gossip site's earlier publication of stories about his private life. But if the lawsuit is not frivolous, it is hard to see how the motivations of funders are relevant (or discernible). One would not say a civil rights organization could not accept donations from philanthropists angered by a personal experience with discrimination. All Thiel has done is cut out the middleman. Indeed, Thiel's conduct fits into the "public interest" or "ideological" litigation paradigm.").

[648] "Outcome-motivated funders" is a term coined by this author.

for Tobacco-Free Kids provided financial support and technical assistance to the government of Uruguay for its defense against the tobacco company Philip Morris in the ICSID case *Philip Morris v. Uruguay* in which Philip Morris challenged state regulations requiring plain packaging of tobacco products.[649]

In addition, many outcome-motivated funders and the parties they fund are inclined to voluntarily, and even publicly, announce their involvement in the case, perhaps to sway public opinion in their favor or to attract additional funding sources for their cause. For example, Bloomberg Philanthropies and the Bill & Melinda Gates Foundation have partnered together to create the Anti-Tobacco Trade Litigation Fund to help low- and middle-income countries finance their defenses against tobacco companies' claims under investment treaties.[650] Former New York City Mayor Michael Bloomberg also appeared in person at the January 2016 Annual Meeting of the Association of American Law Schools and pledged in his remarks that his foundation would support countries that did not have the financial means to defend against arbitrations brought by tobacco companies like Philip Morris.[651]

Regardless of the term adopted to describe this new category of funders, arbitral tribunals, and institutions, the majority of the disclosure rules summarized in this article incorporate definitions of third-party funding that include disclosure of these types of funders in addition to traditional for-profit funders in international arbitration. Hopefully, we may be able to assess the impact of outcome-motivated funding on international arbitration in the future, once more such cases become public.

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[649] *See Historic Win for Global Health: Uruguay Defeats Philip Morris Challenge to Its Strong Tobacco Control Laws*, CAMPAIGN FOR TOBACCO-FREE KIDS (July 8, 2016), http://www.tobaccofreekids.org/press_releases/post/2016_07_08_uruguay; Philip Morris Brand Sàrl, Philip Morris Products SA, and Abal Hermanos SA v. Oriental Republic of Uru., ICSID Case No. ARB/10/7.

[650] *See The Anti-Tobacco Trade Litigation Fund from Bloomberg Philanthropies and the Bill & Melinda Gates Foundation*, CAMPAIGN FOR TOBACCO-FREE KIDS, https://www.global.tobaccofreekids.org/what-we-do/global/legal/trade-litigation-fund; Sabrina Tavernise, *New Global Fund to Help Countries Defend Smoking Laws*, N.Y. TIMES, (Mar. 18, 2015), https://www.nytimes.com/2016/03/19/health/new-global-fund-to-help-countries-defend-smoking-laws.html

[651] *See* Remarks of Michael Bloomberg, Opening Reception, Association of American Law Schools Annual Meeting, 7 Jan. 2016, https://www.aals.org/aals-newsroom/2016-aals-annual-meeting-highlights/

CONCLUSION

As illustrated in this article, disclosure rules relating to third-party funding in international arbitration are an important step toward dispelling widespread misconceptions about third-party funders. Because third-party funders do not directly take part in the international arbitration procedure itself (normally), they are not visible participants in the process. Yet, their behind-the-scenes influence makes them substantial, invisible stakeholders. Some observers take the view that arbitrators, institutions, and opposing parties should not inquire into a party's means to pay the costs of arbitration, which could be termed the "none of your business" approach. Others believe that it would be best for the arbitration system for third-party funders to expressly join the international arbitration community rather than exist on the outskirts or in the shadows. Regardless of where one falls on the spectrum of this debate, the disclosure rules summarized in this article are aimed at helping the international arbitration community improve its collective understanding of the complexities and nuances of third-party funders in international arbitration and ensure the legitimacy of the international arbitration system.

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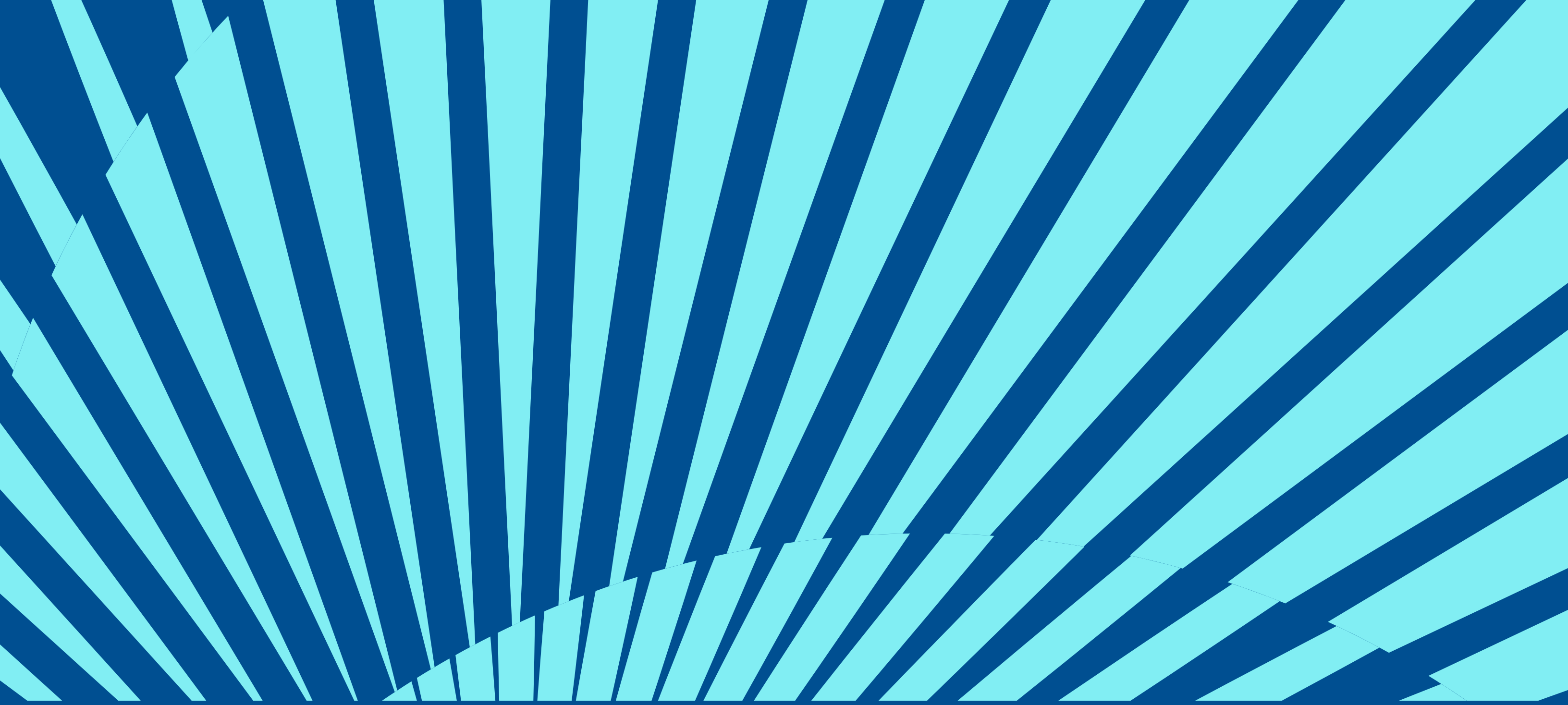

Grim Realities

Debunking Myths in Third-Party Litigation Funding

August 2024

U.S. Chamber of Commerce
Institute for Legal Reform

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John H. Beisner, Jordan M. Schwartz,
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Meagher, & Flom LLP

Executive Summary

Chapter

01

Third-Party Litigation Funding (TPLF)—the practice by which non-parties invest in litigation by paying money to a plaintiff or his/her counsel in exchange for a contingent interest in any proceeds from the lawsuit—has become a dominant feature of the civil justice system in the United States and abroad. But despite its ubiquity, TPLF operates largely in secret without any meaningful oversight, distinguishing it from virtually every other industry.

Because there is no uniform disclosure requirement for TPLF agreements in civil litigation, neither the court nor the opposing parties typically even know whether TPLF is at play in a given case, much less whether it raises any particular legal or ethical issues. One of the primary reasons why TPLF has evaded such basic transparency is because the funding industry has successfully promoted a series of myths that boil down to the claim that TPLF is a benign—and usually salutary—business model that increases litigants' access to justice and that should be of little interest to courts and lawmakers. This paper seeks to debunk this false narrative by chronicling recent examples that illustrate the potential abuses of TPLF, all of which have led judges and policymakers to start taking a closer look at TPLF, potentially laying the groundwork for much-needed reforms.

Part I of this paper addresses the longstanding myth touted by the funding industry that TPLF is essentially a benevolent business model designed to increase access to justice. This repeated claim was highly dubious when TPLF first emerged in the U.S. civil justice system more than a decade ago, given the longstanding policy in this country to permit plaintiffs' lawyers to work on a contingency-fee basis and to protect plaintiffs from the consequences of bringing losing claims with the American rule against fee shifting. Indeed, recent examples confirm that far from serving as an altruistic business endeavor for allegedly injured claimants, TPLF is just a vehicle for maximizing funders' return on their investments—often to the detriment of the plaintiffs whose claims they are bankrolling. Specifically, Part I chronicles several examples in which investors have: (1) attempted to or successfully seized control of the litigations they finance to the detriment of actual claimants; (2) provided a means for foreign interests to potentially evade sanctions, or harass or even steal information from American companies or those from allied countries; or (3) siphoned off significant funds intended to make litigants whole.

Part II of this paper details the increasing concerns expressed by courts, judges, legislators, and regulators regarding the secrecy surrounding TPLF and the potential abuses the practice inflicts upon our civil justice system, as reflected by the recent examples just mentioned. In particular, several states have already taken the lead in trying to rein in these distortive effects of TPLF by, for example, mandating disclosure of TPLF in all civil cases, making funders jointly liable for costs and sanctions due to the abuses associated with litigation funding, or prohibiting such investors from exercising any control or influence over litigation or settlement decisions. And while there remains no uniform federal disclosure regime, more and more individual judges are inquiring about TPLF and requiring litigants to disclose whether they are using it in their cases. In short, contrary to the funding industry's claims, TPLF is very much on judges' and policymakers' radar, which suggests that the time is ripe for robust reform of this clandestine practice.

… [R]ecent examples confirm that far from serving as an altruistic business endeavor for allegedly injured claimants, TPLF is just a vehicle for maximizing funders’ return on their investments—often to the detriment of the plaintiffs whose claims they are bankrolling.

Litigation Funders Are Not Altruistic Investors

Chapter 02

One of the most common refrains from the funding industry and its supporters is that TPLF is entirely benign, if not beneficial. They claim that the industry provides increased access to the justice system by providing funds to litigants who would otherwise not be able to access the courts. However, as the recent examples discussed below show, non-party litigation investors have one goal: to maximize profits regardless of the effects on the litigants whose claims they seek to profit from.

Funders Can Exercise Immense Control Over Litigations in Which They Invest

One of the most notorious myths pushed by litigation funders is that they are nothing more than passive investors who do not exert any control over litigation. Promoting that claim has been key to stymying efforts to adopt an amendment to the Federal Rules of Civil Procedure requiring the production of funding agreements at the outset of a lawsuit. Indeed, in response to such a proposal, the Committee on Rules of Practice and Procedure wrote that "[n]o specific examples [of control] are provided" and that "[t]hird-party funders meet these arguments by direct denial."[1] And funders have continued to push the narrative that they have no influence or control over the course of litigation.[2]

However, recent developments demonstrate that this claim cannot be squared with reality. The most notable recent example is a dispute involving Burford Capital, one of the largest TPLF firms, which publicly claims that it merely "monitors cases as a passive investment partner"[3] and "does not control strategy, settlement or other litigation-related decision-making."[4] In March 2021 and June 2022, Sysco Corporation filed a pair of antitrust lawsuits against suppliers of pork and beef, alleging that they had engaged in conspiracies to "fix, raise, maintain, and stabilize" the prices of pork and beef in violation of the Sherman Act.[5] Those litigations proceeded largely as expected, until suddenly, in March 2023, Sysco filed "stipulations" that its counsel, Boies Schiller, was withdrawing from the litigations and sought a stay while it tried to find new counsel.

What apparently caused the souring of Sysco's relationship with its attorneys was Burford. Unbeknownst to the court, Burford had bet on the litigation in hopes of collecting a payday by financing Sysco to the tune of "approximately $140 million" over the years.[6]

The consideration Burford negotiated was far more than a potential return on a mere passive investment; rather, the funding agreement required that Sysco immediately email Burford any settlement offer it received and that it "shall not accept a settlement without [Burford's] prior written consent, which shall not be unreasonably withheld."[7] In other words, Sysco was not allowed to settle its own case unless Burford approved of the settlement. Once Sysco began receiving settlement offers it found to be reasonable and in its best interest, Burford allegedly sought to obstruct further settlement negotiations, fearing the amounts were too low.[8] In short, even though the parties to the lawsuit believed they had found a fair price and no longer wanted to continue litigation, according to Sysco Burford was forcing it to push on and prolong the litigation.

Moreover, Burford's meddling did not stop at simply refusing to consent to Sysco's acceptance of settlement offers. Instead, Burford instituted proceedings to enjoin Sysco from finalizing settlements, and an arbitral panel granted an ex parte temporary restraining order in Burford's favor.[9] Even worse, Burford allegedly turned Sysco's own counsel against it—counsel who had been representing Burford in other matters and allegedly "played a role in counseling its client Burford to veto its other client Sysco's" settlements.[10] As described by Sysco, Burford then took further steps to control the litigation, writing Sysco a letter "demand[ing]" that it take certain litigation actions, including:
(i) withdrawing certain litigation motions;
(ii) suggesting that Sysco retain a law firm that had reached out to Burford seeking to be retained in the matter; and
(iii) "initiat[ing] an entirely new lawsuit against a number of Sysco's key suppliers of turkey."[11] According to Sysco, Burford even "threatened that if Sysco does not comply with each of these extraordinary demands," Burford would "invoke [] a 'nuclear option' in the original funding agreement that would allow Burford to seize complete control of Sysco's claims (including by hiring and firing Sysco's counsel)."[12]

Eventually, Sysco—in an attempt to extricate itself from litigation it no longer wished to pursue—reached an agreement with Burford under which Sysco's claims were assigned to a Burford affiliate, Carina Ventures LLC (Carina).[13] While the magistrate judge overseeing a series of the cases permitted the assignment of the claims from Sysco to Carina, he ultimately rejected Carina's motion to substitute as the plaintiff, reasoning that "condoning Burford's efforts to maximize its return on investment would" cause the harm of "forcing litigation to continue that should have settled."[14] As the court explained, the "litigation burden caused by Burford's efforts to maximize return on investment" was "enormous," consisting of a "state court in New York and two federal district courts" being involved in litigation "over enforcement of the arbitration award Burford obtained" in addition to the arbitration proceedings themselves.[15] Even beyond that, the court was forced to "partially stay two of the largest cases on its docket for 60 days" and deal with the bevvy of motions accompanying the dispute between Burford and Sysco.[16]

Moreover, the reason Burford went to such lengths to enforce its funding agreement with Sysco and effectively exercise veto power over settlements Sysco deemed to be in its best interest was obviously not to further the interests of any aggrieved claimant but rather to maximize Burford's own returns, including in other cases. As the court observed, there "seem[ed] to be in place" other "as-yet-undisclosed financing agreements" between Burford and other parties, meaning that if Sysco's settlement went through, it would "set benchmarks for other settlements with other defendants" that were too low, whereas if Sysco's settlement were higher, Burford would realize a higher return in its other cases as well.[17] Put another way, Burford was effectively controlling one case because of how it might affect other potential investments.

In June 2024, the District Court upheld the magistrate judge's order over Sysco and Carina's objections, noting that "[t]he Magistrate Judge was rightly concerned that allowing substitution ... could encourage litigation financers everywhere to use mid-litigation assignments and substitutions to undermine agreements between parties otherwise willing to settle."[18] By contrast, another district court judge in the Northern District of Illinois allowed the substitution in a related case, implicitly countenancing Burford's conduct.[19] In a perfunctory order, the judge there reasoned that "Sysco is a sophisticated and large corporation, and not a simple and ordinary individual who is vulnerable to the temptation of a 'wicked' non-party 'willfully' intending to 'stir up' or 'foment useless ... or meritless litigation ... for the sake of harassment'" and found that defendants' "concern that Carina's substitution will meaningfully frustrate any future attempts for settlement discussions" was "insufficient" to stop the maneuver.[20] The divergence of judicial opinions on Burford's conduct illustrates conflicting approaches to

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Importantly, the Sysco dispute is not anomalous. The allegations of control there are consistent with numerous other examples of actual TPLF agreements that grant a TPLF entity authority to control or influence aspects of the funded litigation.[21] The recent episode involving Sysco and Burford is just the most recent and most publicized on a list of examples illustrating that the funding industry's representations about its purportedly hands-off approach to litigation are simply not credible.[22] In short, at least in some cases, the TPLF industry is not opening the courthouse

Taken together, the information leaked in connection with the various lawsuits regarding an otherwise secretive industry reveals how TPLF funders can seek to control every aspect of the mass arbitrations they fund and view themselves, and not the litigants whose claims they finance, as the primary clients of those litigants' attorneys.

doors or providing funds for litigants that their counsel would not otherwise be able to expend via contingency-fee arrangements, but rather is actively using parties in litigation as vehicles to maximize profits.

Third-Party Funders Move Into Mass Arbitrations

Mass arbitrations have proven ripe for abuse by unscrupulous attorneys who routinely use unsuspecting plaintiffs to essentially shake down corporate defendants.[23] These abuses have been compounded by the addition of TPLF money that has turbocharged these efforts, often with the stated understanding that the attorneys who bring these claims will do no work on the arbitration except for recruiting the plaintiffs used as leverage. The realities of TPLF use and manipulations of mass arbitrations recently exploded into view following the public airing of grievances in connection with four separate lawsuits among and between a mass arbitration plaintiffs' firm (Zaiger LLC (Zaiger)), an attorney and former partner of that firm (William Bucher), a third-party litigation funder (Black Diamond Capital Management (Black Diamond)), and the target of one of the firm's TPLF-funded mass arbitrations (Valve Corporation (Valve)). The recriminations contained within the complaints and their vitriolic language show just how bitter the disputes can become between litigation funders and the attorneys they see as nothing more than a conduit for pecuniary gain.

The saga began in April 2023, when Mr. Bucher filed a nine-count suit against Zaiger, employees of Zaiger, and Black Diamond alleging, among other things, wrongful termination, false advertising, and tortious interference with business expectancies.[24] In response, Zaiger filed suit against Mr. Bucher, alleging fraud, unfair competition, and tortious interference with contractual relations.[25] Based on the information disclosed in those lawsuits, Valve then filed suit against Bucher, Zaiger, and Black Diamond alleging abuse of process and tortious interference with the contracts between it and its customers.[26] Taken together, the information leaked in connection with the various lawsuits regarding an otherwise secretive industry reveals how TPLF funders can seek to control every aspect of the mass arbitrations they fund and view themselves, and not the litigants whose claims they finance, as the primary clients of those litigants' attorneys.

Prior to August 15, 2022, Zaiger had a single client, Black Diamond, and represented only that entity, its subsidiaries, and its employees and their spouses.[27] In fact, according to Mr. Bucher, "Black Diamond essentially created Zaiger LLC as a captive law firm to perform legal work for Black Diamond and its affiliates"; thus, the two entities "were (and are) intertwined in fundamental ways that are unheard of in the legal industry."[28] Prior to his involvement with Zaiger and Black Diamond, Mr. Bucher's legal practice had focused on defending corporate clients against mass arbitrations.[29]

In January 2022, however, Mr. Bucher met Jeff Zaiger, the principal of Zaiger LLC, to discuss the possibility of building a plaintiff-side mass arbitration practice at Zaiger.[30] In an effort to convince Mr. Bucher to join the firm, Mr. Zaiger "represented that he could not only offer [Mr. Bucher] the infrastructure and resources of an existing firm to build [the] practice but that he [also] had a close relationship with Black Diamond … as a potential source of funding mass arbitration cases."[31] As Mr. Bucher himself noted, that potential funding was critical: "[m]ass arbitration cases are very capital intensive for a plaintiff because they must have the resources to file initial arbitration filing fees for tens of thousands of consumers. This means millions must be spent at the outset of a case, and without the funding to file the cases, a mass arbitration strategy cannot get off the ground."[32]

> "Indeed, Black Diamond allegedly made clear that it would not provide any investment unless it controlled the venture, including whether to continue the litigation, as 'litigation of the cases after Valve had paid its arbitration fees would be fruitless.'"

To that end, in June 2022, Messrs. Zaiger and Bucher created a slide deck outlining their proposal to bring a mass arbitration action against Valve that Mr. Zaiger in turn shared with Black Diamond for consideration.[33] Among other things, the slide deck (1) provided a "lifecycle of investment" detailing how Black Diamond's investment would be put to work,[34] (2) set forth a proposal to bring 75,000 arbitration claims against Valve in connection with claims that the company had engaged in monopolistic behavior,[35] and (3) estimated that Black Diamond could expect a return of almost 19 times on an investment of $6.5 million.[36]

Mr. Bucher began working for Zaiger less than two months later, on August 15, 2022.[37] The next day, Black Diamond entered into an agreement (the "Seed Funding Agreement") to provide $500,000 in seed funding for the mass arbitration strategies.[38] According to Bucher, by November 2022 he and Zaiger had recruited more than 20,000 prospective clients for a mass arbitration against Valve and by February 2023, they had recruited more than 48,000.[39] However, according to Bucher, Black Diamond never actually provided any of the $500,000 in promised seed funding under the Seed Funding Agreement; Mr. Zaiger funded the initial recruitment out of his own funds.[40]

Shortly thereafter, the CEO of Black Diamond proposed new terms for the parties' contract. According to Bucher, chief among them was a requirement that Zaiger would agree to terminate the mass arbitration against Valve if the company did not immediately settle the case upon notice that the mass arbitration plaintiffs had paid their filing fees.[41] Indeed, Black Diamond allegedly made clear that it would not provide any investment unless it controlled the venture, including whether to continue the litigation, as "litigation of the cases after Valve had paid its arbitration fees would be fruitless."[42] After Bucher expressed concern at those terms and tried to secure alternate funding for the mass arbitration,[43] Black Diamond allegedly forced Zaiger to terminate Bucher and seized control of the mass arbitrations.

In sum, the Valve saga shows that when lawyers comply with their duty of loyalty to ensure their clients have final say about the prosecution of their cases, TPLF firms may attempt to wrest control of the litigation from those lawyers. This episode is yet another example of TPLF investors being active (rather than passive) actors and subordinating the interests of purportedly aggrieved claimants to their own objective of maximizing profit.[44]

Foreign Entities Are Investing in U.S. Litigation, Raising National Security and Sanctions Evasion Concerns

In addition to undermining plaintiff control and the professional independence of attorneys, TPLF also poses serious national security concerns.[45] Several prominent legislators have recently voiced their concerns regarding the risks of foreign influence in TPLF, most recently including Sens. John Cornyn (R-TX) and Thom Tillis (R-NC). In a July 11, 2024 letter to the Committee on Rules of Practice and Procedure of

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the Administrative Office of the United States Courts, the Senators warned that "[l]itigation funding is an available weapon for foreign investors to attack domestic businesses" and that "[f]oreign adversaries could use litigation funding mechanisms to weaken critical industries or obtain confidential materials."[46] Sens. Cornyn and Tillis urged the Committee to promulgate a rule addressing these concerns.[47]

These concerns echo those expressed by U.S. Sens. Marco Rubio (R-FL) and Rick Scott (R-FL) in November 2023. In letters to the chief judges of Florida's federal district courts, the Senators "highlight[ed] the dangers of foreign [TPLF] and the need for more transparency in the federal judiciary as it relates to this matter."[48] They explained that foreign funding can originate from several sources, including sovereign wealth funds (SWFs), and may influence both the nature and direction of a litigation through often undisclosed financial contributions.[49] Specifically, they noted that the most concerning outcome would be that "these foreign funders have the potential to provide hostile foreign actors with sufficient ways to exert undisclosed influence on litigation moving through the federal judiciary."[50]

These concerns were also at the forefront of a December 2023 report by the House Select Committee on the Strategic Competition Between the United States and the Chinese Communist Party. In that report—titled Reset, Prevent, Build: A Strategy to Win America's Economic Competition with the Chinese Communist Party—the Select Committee recommended that Congress "[d]etermine, and then establish, what guardrails are needed to address the possibility of foreign adversary entities obtaining sensitive IP through funding third-party litigation in the United States."[51] The Select Committee also recommended "requir[ing] enhanced disclosures for foreign adversary entities and provid[ing] judges with the authority to require enhanced disclosures for certain entities under foreign adversary entity control regarding their funding, and, when appropriate, ownership and connection with the foreign adversary government and dominant political party."[52]

The Executive Branch has also become increasingly concerned about the risks surrounding foreign TPLF in U.S. litigation. For example, at the state level, 14 state attorneys general sent a letter to the U.S. Department of Justice, bemoaning the secrecy surrounding TPLF and questioning what U.S. Attorney General Merrick Garland and other top officials are doing to ensure that the practice is not threatening U.S. national security interests.[53]

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Similarly, in his first remarks after assuming the role in December 2023, Foreign Agents Registration Act (FARA) Unit Chief Evan Turgeon addressed this important topic in detail.[54] Among other things, Mr. Turgeon discussed FARA's application to foreign funding of litigation in the U.S.[55] And he specifically identified three potential risks of "undisclosed and undiscoverable" third-party foreign funding of U.S. litigation:

- Foreign entities doing business in the U.S. may seek to create a competitive advantage as compared to their U.S. competitors by tying up U.S. companies in lengthy and expensive court cases.
- Foreign funders of U.S. litigation may gain access to proprietary and sensitive commercial information through litigation discovery.
- Foreign adversaries may fund litigation on political issues that are divisive within the U.S. public.[56]

These concerns are not new. More than a decade ago, TPLF expert Professor Maya Steinitz warned that SWFs, like the China Investment Corporation (CIC), "could file suit against an American company in a sensitive industry such as military technology" and over the course of that litigation, receive "highly confidential documents containing proprietary information regarding sensitive technologies from the American defendant-corporation."[57] In 2023, Sen. John Kennedy (R-LA) highlighted similar concerns in a letter to Chief Justice John Roberts and Attorney General Merrick Garland, warning that solely "by financing litigation in the United States against influential individuals, corporations, or highly sensitive sectors, a foreign actor can advance its strategic interests in the shadows since few disclosure requirements exist in jurisdictions across our country."[58]

While the secrecy surrounding TPLF makes it impossible to ascertain the precise extent and intention of foreign-sourced TPLF in the U.S., it is clear that foreign investment in U.S. litigation is occurring. For example, SWFs are undeniably involved in U.S. litigation.[59] The details of traditional funders' relationships with SWFs have largely remained hidden, but two companies with ties to Russia and China raise serious questions about whether litigation is being manipulated by foreign interests.

Russian TPLF and Sanctions Evasion

In an effort to evade international sanctions, Russian billionaires with ties to Vladimir Putin have financed lawsuits around the world through their investment firms.

Specifically, Bloomberg investigated A1, a company that is a subsidiary of the Russian investment company Alfa Group. It was discovered that "A1 has spent about $20 million in ongoing bankruptcy cases in New York and London on behalf of a Russian agency seeking to recover assets from a brother and sister accused of embezzling more than $2 billion from a Moscow bank."[60] After three A1 directors were sanctioned in the UK, they sold A1 for the token sum of $900 to another A1 director. During a subsequent bankruptcy proceeding, the director who purchased A1, Alexander Fain, conceded that he had purchased A1 because of a "'complicated geopolitical situation' potentially affecting the litigation."[61] UK courts have considered and agreed that A1's maneuver essentially constituted an attempt to evade sanctions. In May 2024, a UK judge held that there is reasonable cause to suspect that Russian litigation funder A1 is owned or controlled by people sanctioned in the UK.[62] In her opinion, Justice Sara Cockerill echoed concerns raised in a February 2023 proceeding, in which another judge, Lady Justice Falk, held that it was "impossible ... to dispel the concern that the March 2022 transaction was not genuine, but instead to give the appearance that A1 is no longer under the control of sanctioned individuals."[63] Judge Cockerill also noted that although A1 is no longer funding the case, it has been replaced by another Russian company and third-party payor, Cezar Legal Consulting Agency.[64]

A1's maneuver has appropriately raised serious concerns within the U.S. government. After Bloomberg's investigation, Deputy Treasury Secretary Wally Adeyemo specifically addressed litigation investment financing by foreign actors in a Senate hearing. In his testimony, he noted that the Treasury Department needs "to both work on and try and address" the use of litigation funding by foreign actors.[65] This remains particularly important given the varied levels of control foreign investors may exert. In this instance, A1 "actively participated" in the New

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York and London litigations, ranging from involvement in day-to-day decisions to directing legal strategy from Russia.[66] The A1 example illustrates the potential of foreign litigation funders using litigation in the U.S. and in allied countries like the UK to avoid international sanctions, which would constitute a blatant (and highly concerning) circumvention of longstanding national security protocols.

Chinese TPLF and Improper Disclosure of Discovery Materials

In addition to potential evasion of U.S. and international sanctions, foreign investment in U.S. litigation also raises concerns over the misuse of confidential information by foreign actors, including potential adversaries. Recent disputes involving Purplevine IP Operating Co., Ltd. (Purplevine) are ground zero for these serious concerns. Purplevine, a China-based firm that markets itself as a one-stop IP service provider, is financing at least four intellectual property lawsuits in U.S. courts against Samsung Electronics Co. (Samsung) and a related subsidiary.[67] Unlike in most cases, Purplevine's role within the litigation was involuntarily disclosed during litigation in Delaware due to a standing order that the judge overseeing the case—Chief U.S. District Judge Colm Connolly—had previously entered requiring certain basic TPLF-related disclosures.[68] This disclosure, subsequent reporting, and facts learned at trial revealed a tangled relationship between this litigation funder and the patent claims at issue and suggest that Purplevine may have received and relied upon privileged, confidential, and highly sensitive information in bankrolling Staton Techiya, LLC's (Techiya) patent infringement claims against Samsung.

In recent redacted filings, Samsung summarized the history of its dispute with Techiya, which began when Techiya alleged that Samsung had infringed several of its patents.[69] Samsung disputed these allegations and alleged that Techiya had (1) violated the Defend Trade Secrets Act (DTSA), and (2) assisted two former in-house lawyers' breach of their fiduciary duties, asserting an unclean hands defense.[70] During an initial trial, it emerged that the two former in-house lawyers had stolen privileged and confidential analysis of the patents and relevant reports.[71] In particular, Samsung's investigation revealed that the privileged analysis was sent to both Purplevine and PV Law, Techiya's outside counsel, and that Purplevine considered this information when deciding to fund the case.[72] Samsung also suggested that while Purplevine had intentionally sought to minimize its relationship with PV Law, this was not credible given the abbreviation (PV) and the two entities' shared address.[73]

Samsung now argues that both Purplevine and PV Law should be added as

> “The reality is that it is simply a matter of time before an intellectual property case is funded by a foreign adversary seeking to undermine American national security, if it has not already occurred. Indeed, Chinese companies pose a particular concern given that many high-ranking Communist Party officials serve as officers and directors of entities that otherwise appear to have no connection to the Chinese state.”

counterclaim defendants to the lawsuit due to their misappropriation of trade secrets, noting that they “encouraged and benefited from the theft of Samsung’s privileged and confidential information.”[74] Samsung describes both Purplevine’s and PV Law’s actions, one as a litigation funder and the other as the “strategic U.S. law firm partner” of the same, as a “subversion of our adversarial system of litigation and an invasion of the attorney-client privilege.”[75] Although the patent technology at issue in the case before Judge Connolly related to sound systems and did not directly implicate national security concerns per se,[76] the alleged misappropriation of discovery and other confidential litigation materials in the case illustrates the kind of misconduct that could unfold when a foreign entity chooses to fund litigation involving sensitive technology (e.g., semiconductors) that is critical to U.S. national security. Indeed, another case, funded by a subsidiary of a foreign bank, resulted in a $2.2 billion judgment against Intel, which is one of the largest manufacturers of highly sensitive U.S. semiconductor technology.[77] The reality is that it is simply a matter of time before an intellectual property case is funded by a foreign adversary seeking to undermine American national security, if it has not already occurred. Indeed, Chinese companies pose a particular concern given that many high-ranking Communist Party officials serve as officers and directors of entities that otherwise appear to have no connection to the Chinese state.

While this case appears to be the first documented example of a foreign litigation funder allegedly being part of the misappropriation of confidential information, the only reason it came to light was because the court overseeing the original litigation happened to have in place a standing order requiring basic TPLF-related disclosures. Because such orders are the exception rather than the norm, and given the plaintiffs’ bar’s and the funding industry’s vociferous resistance to disclosing TPLF arrangements in their cases, there is no way to know with any certainty whether Purplevine, SWFs, or even potential adversaries are manipulating TPLF in a similar or even more nefarious manner. But "[g]iven the concerted effort and enormous resources expended by foreign adversaries to pursue their national security goals, there is no reason to believe that exploiting litigation financing would be excluded from their toolbox."[78] The example involving Samsung highlights the very real risk of improper disclosure of sensitive discovery materials to foreign interests and suggests that Professor Steinitz's decade-old warning was well-grounded.

Litigation Funders Bleed Off Recovery Intended for Litigants

One of the most deceptive claims promoted by the funding industry is that TPLF helps make purportedly injured claimants whole. The opposite is often true. Indeed, while the percentage that each TPLF funder demands for its investment is a closely guarded industry secret, one recent report explained that investors typically seek returns of three to four times their investment for a single lawsuit, or around 18% when they invest in a portfolio of lawsuits.[79] That 18% figure is roughly equivalent to a very high-interest loan, or roughly 1.25 times the current average yield of a "junk bond" (14%)—

> One of the most deceptive claims promoted by the funding industry is that TPLF helps make purportedly injured claimants whole. The opposite is often true.

typically the last resort of companies seeking capital.[80] It is therefore no surprise that TPLF investors are proactive in influencing and controlling their investments—i.e., protecting them. As previously discussed, that can consist of exercising influence over litigation strategy and effectively wielding veto power over settlement decisions. And as elaborated below, such a strategy also entails TPLF investors aggressively enforcing one-sided funding agreements that enrich themselves to the detriment of the plaintiffs whose claims they are financing.

A recent dispute between Arigna Technology Limited (Arigna) and TPLF company Longford Capital Fund III, LP (Longford), illustrates the lengths to which funders may be willing to go to enforce agreements that favor the interests of the investors over those of the plaintiffs. In August 2020, Arigna retained Susman Godfrey L.L.P. (Susman) to enforce its intellectual property rights against various entities.[81] The engagement letter between Arigna and Susman defined the attorney-client relationship between Susman and Arigna and outlined a number of patent enforcement actions Susman would pursue on Arigna's behalf.[82] The engagement letter also explained that Arigna would not finance the patent enforcement actions itself.[83] Instead, in exchange for some portion of the settlement proceeds secured by the enforcing campaign, Longford agreed to pay all the up-front costs, expenses and fees associated with the campaign. The funding agreement and the engagement letter were executed on the same day, and each was attached as an exhibit to the other.[84]

In November 2023, Arigna entered into a settlement agreement against one of the targets of the enforcement campaign.[85] Pursuant to that agreement, one of Arigna's affiliates received a $100 million payment.[86] Shortly thereafter, Longford asserted that pursuant to the funding agreement, it was entitled to $32 million, or 32% of the settlement.[87] Arigna demurred, asserting that the funding agreement only entitled Longford to collect from the portion of the settlement paid to Susman under the engagement agreement, and not from the entire $100 million settlement.[88]

Seeking to vindicate its position, Arigna filed suit in Delaware federal court on January 9, 2024.[89] Arigna sought a declaration from the court that Longford's claim to any settlements achieved from the patent enforcement campaign was limited to the amounts paid to Susman, and not the total settlement value.[90] In response, Longford filed an arbitration action in Houston and sought to compel arbitration to resolve the question.[91]

On June 5, 2024, the Court granted Longford's motion and denied Arigna's countermotion to enjoin Longford's arbitration action.[92] While the outcome of this dispute is not yet clear, Longford's successful motion to compel arbitration may be a harbinger of an ultimate arbitral decision that endorses Longford's position that it is entitled to 32% of the $100 million settlement. Such an amount would be in addition to whatever money Arigna owes its counsel, which is typically between 25% and 33% of the overall proceeds. Accordingly, if Longford ultimately has its way, well over half of the settlement proceeds will be going to the lawyers and investors, underscoring that TPLF further dilutes compensation to claimants.[93]

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Courts and judges have begun taking note of the aggressive terms often demanded by TPLF funders, expressing growing concern about outside investors draining settlement funds intended for those who have allegedly been injured by a defendant's purported misconduct. For example, in August 2023, the judge presiding over the Combat Arms Earplug (CAE) multidistrict litigation proceeding and a recent $6.8 billion settlement between 3M and thousands of U.S. military veterans issued an extraordinary order that required plaintiffs' counsel "to disclose all third-party litigation funding agreements entered into by any CAE claimant they represent, whether the agreement was executed before or after a settlement of the CAE claimant's claim."[94] Indeed, the court promised it would "review those contracts with a high degree of scrutiny" after noting that "for at least the past decade, settlements of th[e] size and nature [of the 3M settlement] have often attracted the attention of third-party litigation funding entities intending to prey on litigants, including settlement participants seeking litigation funding pending the receipt of potential settlement funds."[95] Judge Casey Rodgers did not mince words, recognizing that these agreements often included "exorbitant fees and rates of interest."[96] Thus, to ensure that the 3M plaintiffs were "not exploited by predatory lending practices, such as interest rates well above market rates, which [could] interfere with their ability to objectively evaluate the fairness of their settlement options," the court ordered plaintiffs' counsel to disclose any TPLF agreements.

What made Judge Rodgers' order truly extraordinary, however, was that it went beyond simply requiring disclosure of the agreements.[97] In perhaps the first order of its kind, Judge Rodgers ruled that "as of the date of entry of [her] Order, [plaintiffs' counsel] must not participate in, consent to, or approve any third-party litigation funding agreement to a CAE claimant."[98] The judge also prohibited any plaintiff from "obtain[ing] third-party litigation funding, absent the filing of a motion with, and obtaining the prior approval of, [the] Court."[99] Judge Rodgers' concerns are well-founded, given that in 2022, 70% of TPLF funding went to mass tort portfolios.[100]

Judge Rodgers' order and the two orders in the Arigna litigation are the latest illustrations of a fundamental reality: TPLF is designed to maximize funders' return on investment, not to promote the interests of claimants. TPLF incentivizes investors taking a substantial percentage of money supposedly intended to make litigants whole, which, as Judge Rodgers noted, can make parties reject otherwise reasonable settlements in an attempt to recover the funds they actually need to properly recover.

In sum, recent examples belie the longstanding myth promoted by the funding industry that TPLF is an essentially benevolent business model designed to increase access to justice. Rather, as the examples in this chapter show, TPLF investors have: (1) attempted to or successfully seized control of the litigations they finance to the detriment of the plaintiffs; (2) provided a means for foreign interests to potentially evade sanctions or harass or even steal information from American companies or those from allied countries; or (3) siphoned off significant funds intended to make litigants whole. In so doing, TPLF has undermined our civil justice system.

Decision Makers Are Growing Increasingly Concerned About TPLF

Chapter 03

Another myth spread by the TPLF industry is that judges, lawmakers and policymakers have rejected attempts to make TPLF more transparent, and that they are somehow indifferent about its potential abuses on our civil justice system. Essentially, TPLF investors are perpetuating a narrative that the existence of TPLF and the content of funding agreements are off-limits and completely immune from transparency and government oversight. This myth is just as fallacious as the claim by TPLF funders that they exist solely to increase access to justice and are merely passive investors.

In truth, TPLF is very much on government's radar at both the state and federal levels (as well as abroad).[101] As discussed below, the courts, legislatures, and regulators are becoming increasingly proactive in scrutinizing TPLF and requiring greater transparency of the practice, and are setting the stage for much-needed reform of its usage.

Actions by Courts and Judges

In recent years, there has been increasing judicial recognition of the need to make TPLF more transparent, with a growing number of district courts and individual judges requiring some form of TPLF disclosure. As previously discussed, Judge Rodgers recently issued an unprecedented order in the 3M litigation to mitigate the abuses of TPLF. A number of district courts and individual judges have also started taking TPLF more seriously by requiring some basic transparency related to this practice.

Federal District Court Rules

Several district courts have adopted local rules requiring TPLF-related disclosures. These disclosure requirements vary. For example, the District of New Jersey requires that each party must file a certification within 30 days of docketing of the case that discloses the identity of any litigation funder (name, address, place of formation), states whether the funder's approval is necessary for litigation and settlement decisions, and provides a description of the nature of the financial interest.[102] The order also authorizes discovery related to TPLF, including production of the funding agreement itself, "upon a showing of good cause that the [funder] has authority to make material litigation decisions or settlement decisions."[103]

An older and more modest approach to TPLF transparency is reflected in a standing order in the Northern District of California. Unlike the more recent rules summarized above, the Northern

District of California's standing order requires parties to provide limited identifying information, has no provisions for additional discovery of the terms of any agreements, and only applies to class, collective, and representative actions.[104]

Individual Judges' Orders and Inquiries

In addition to district court rules, a growing chorus of federal judges has begun addressing TPLF by entering their own standing orders or making inquiries in the cases they are overseeing. Most notably, Chief Judge Connolly of the U.S. District Court for the District of Delaware has adopted a standing order applicable to cases on his docket that largely mirrors the District of New Jersey's approach.[105] As previously discussed, it was that standing order that led to the revelations involving Purplevine, bringing into public view the potential national and economic security threats posed by foreign investment in U.S. litigation. A number of other federal judges have also taken steps to increase TPLF transparency in their courtrooms. For example:

- Judge Yvonne Gonzalez Rogers of the U.S. District Court for the Northern District of California orally asked each attorney seeking a leadership position in the social media addiction multidistrict litigation (MDL) proceeding to divulge in open court whether he or she is using (or plans to use) TPLF.[106]
- Judge Dan A. Polster of the U.S. District Court for the Northern District of Ohio required that lawyers connected with the opioid MDL proceeding in his court disclose the existence of any third-party funding.[107]
- Judge J. Philip Calabrese, also of the U.S. District Court for the Northern District of Ohio, has a standing order similar to that of Judge Connolly, requiring the parties to disclose any TPLF funding agreements they may have. The parties may submit those disclosures ex parte by email to chambers.[108]
- Judge Paul W. Grimm of the U.S. District Court for the District of Maryland has also required lawyers leading an MDL proceeding concerning a data breach of Marriott hotels to make similar disclosures.[109]

Pending Proposal to Amend the Federal Rules of Civil Procedure

The Advisory Committee on Civil Rules (the body responsible for overseeing changes to the Rules of Civil Procedure) continues to consider a proposed amendment to Rule 26 that would require the production of TPLF agreements as a matter of course in all civil cases. Under that proposal, a party

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"Most recently, on July 12, 2024, Rep. James Comer (R-KY) wrote to Chief Justice Roberts urging the Judicial Conference (the federal judiciary's rule-making body), to review the role of litigation finance. Specifically, Rep. Comer called for concrete judicial reform, including a potential requirement that TPLF in federal lawsuits be disclosed as a matter of course."

would have to disclose "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."[110]

While the increased judicial scrutiny of TPLF is a very important step in the right direction, there are growing calls by lawmakers for the courts to do even more. As previously discussed, Sens. Rubio (R-FL) and Scott (R-FL) have been advocating for judicial action since November 2023.[111] Most recently, on July 12, 2024, Rep. James Comer (R-KY) wrote to Chief Justice Roberts urging the Judicial Conference (the federal judiciary's rule-making body) to review the role of litigation finance.[112] Specifically, Rep. Comer called for concrete judicial reform, including a potential requirement that TPLF in federal lawsuits be disclosed as a matter of course.[113] That letter was sent just one day after Sens. Cornyn and Tillis called for the Advisory Committee to adopt the disclosure proposal previously discussed.[114] While Justice Roberts has not publicly commented on TPLF, his chief deputy and advisor, Judge Robert M. Dow, Jr., has reportedly suggested that disclosing TPLF agreements privately to the judges and parties involved in lawsuits could allay concerns over litigation funders taking control of cases.[115]

With the increased examples of disturbing behavior by funders, it is unsurprising that both courts and lawmakers alike have taken a much greater interest in TPLF over the last several years, and there is every reason to believe such increased scrutiny will continue and ultimately result in the establishment of concrete safeguards for our civil justice system.

Actions by Legislatures

U.S. Congress

The U.S. Congress is also actively considering the risks posed by opaque TPLF and how to address them. Most recently, following a hearing on TPLF usage in U.S. courts,[116] Rep. Darrell

Issa (CA-48), Chairman of the House Judiciary Subcommittee on Courts, Intellectual Property, and the Internet, introduced a discussion draft of the Litigation Transparency Act of 2024.[117] The bill would require the production of TPLF agreements at the outset of any federal civil case, just as defendants are required to turn over insurance agreements to plaintiffs under Rule 26 as a matter of course.

Another proposal currently pending before Congress is the Protecting Our Courts From Foreign Manipulation Act (POCFMA) of 2023—a bipartisan bill introduced by Sens. John Kennedy of Louisiana and Joe Manchin of West Virginia.[118] Speaker Mike Johnson of Louisiana introduced the House version of the legislation. That bill would:
(1) require disclosure of foreign sources of TPLF in American courts;
(2) ban SWFs and foreign governments from investing in U.S. litigation; and
(3) require the DOJ's national security division to submit a report on foreign TPLF to the federal judiciary. As the Senators explain, "[f]oreign actors such as China and Russia use third-party litigation funding to support targeted lawsuits in the United States, undermining our economic and national security," and this Act "would put necessary safeguards in place to ensure that foreign nations, private equity funds and SWFs linked to hostile governments are not tipping the scale in federal courtrooms."[119] The bills have been referred to the House and Senate Judiciary Committees and are awaiting further action.

The States

The growth of TPLF and its attendant problems have also attracted the attention of state legislatures and governors. As summarized below, a number of states have recently enacted laws requiring the disclosure of TPLF arrangements and establishing important protections addressing excessive interest rates and foreign investment in state court proceedings.
For example:

- In 2018, Wisconsin became the first state to require that "a party shall, without awaiting a discovery request, provide to the other parties any agreement under which any person … has a right to receive compensation that is contingent on and sourced from any proceeds of the civil action, by settlement, judgment, or otherwise."[120]
- West Virginia enacted a TPLF disclosure law in 2019, which, like Wisconsin's law, requires disclosure of agreements where a litigation financier has a right to receive

compensation from the lawsuit.[121] In March 2024, West Virginia's governor signed into law amendments that, among other things:
(1) updated the definition of "consumer" to include non-natural people (i.e., businesses);
(2) removed commercial tort claims from the list of items excluded from the definition of TPLF; and (3) clarified that counsel are subject to the disclosure requirement.[122]

- Montana recently enacted a bill requiring the disclosure of TPLF agreements that are used to finance lawsuits brought by consumers.[123] This legislation was passed with a unanimous vote in both chambers of the state legislature. The new law also requires that litigation funders register with the Montana secretary of state, makes funders jointly liable for costs, and establishes a 25% cap on the amount that a funder may receive or recover from a lawsuit.

- Indiana also recently passed a law similarly requiring the disclosure of TPLF agreements with consumer parties.[124] Indiana amended that law to also ban funding by certain foreign parties, prohibit commercial litigation financiers from making litigation and settlement decisions, bar parties from providing sealed or protected documents to their litigation funders, and make the contents of commercial litigation funding agreements discoverable.[125]

- Most recently, on June 19, 2024, Louisiana Gov. Jeff Landry signed into law Senate Bill 355.[126] The newly enacted law requires, among other things, (1) foreign funders to disclose certain information to Louisiana's attorney general, (2) prohibits funders from influencing or making certain litigation and settlement decisions, and (3) makes the existence of TPLF agreements subject to discovery under Louisiana's Code of Civil Procedure and Code of Evidence rules.[127]

Foreign Governmental Examination and Regulation of TPLF

Concern about the scale and spread of TPLF is not limited to the United States. Even abroad, legislators and judiciaries are taking action to better understand the quickly expanding phenomenon of TPLF and how it should be regulated and controlled. Some of the most notable developments concern actions taken by the European Union and the United Kingdom.

European Parliament/ European Commission

In June 2021, Member of the European Parliament (MEP) Axel Voss introduced a legislative own-initiative report titled Responsible Private Funding of Litigation, which called on the European Commission (EC) to legislate on TPLF via a European Union (EU) Directive.[128, 129] That report and its recommendations further highlight the growing consensus that TPLF should be more transparent and be governed by meaningful safeguards. Among other things, the report noted that "[w]here third-party litigation funding activity is permitted, a system for the authori[z]ation and supervision of litigation funders by independent administrative bodies in the Member States is necessary to ensure that such litigation funders meet the minimum criteria and standards laid down in this Directive. Litigation funders should be subject to oversight in a manner similar to that of the existing prudential supervision system applicable to financial services providers."[130] MEP Voss's report also stated that "in order to ensure access to justice for all and that justice systems prioriti[z]e redress for injured parties, and not the interests of private investors who might only be seeking commercial opportunities from legal disputes, it is necessary to establish common minimum standards at Union level, which address the key aspects relevant to TPLF, including transparency, fairness, and proportionality...."[131]

In light of those findings, the report called on the EC to introduce an EU Directive on TPLF and detailed specific safeguards that should be applied to this secretive industry, including: (1) holding funders responsible for adverse costs (i.e., implementing a "loser pays" rule in the event a TPLF-funded lawsuit is unsuccessful); (2) requiring disclosure of funding agreements and their terms to the court and, to some degree, to defendants; (3) banning undue funder control over proceedings; and (4) ensuring the licensing of funders by an independent supervisory authority in the Member States.[132] In September 2022, MEP Voss's report was adopted as a resolution by an overwhelming majority (over 80%) of the European Parliament.[133]

On December 1, 2022, the EC sent its official response

"Even abroad, legislators and judiciaries are taking action to better understand the quickly expanding phenomenon of TPLF and how it should be regulated and controlled."

"'Litigation funders should be subject to oversight in a manner similar to that of the existing prudential supervision system applicable to financial services providers.'"

to the Parliament's resolution on TPLF to Parliament President Roberta Metsola. In a major step towards the regulation of TPLF, the EC agreed to fully engage with Parliament on this issue and follow up on the resolution with an external study. Since then, the EC has asked a consortium of organizations—the German firm Civic Consulting, the British Institute of International and Comparative Law (BIICL), and the Dutch Asser Institute—to conduct the study on TPLF.[134] The study should be completed by January 2025 and is being overseen by the EU Commission Directorate-General for Justice and Consumers.[135]

European Law Institute

In addition to the study commissioned by the EC, another project co-funded by the EU and conducted by the European Law Institute is seeking to develop certain "safeguards" that would "balance[] the availability of [TPLF] with the interests of claimants and defendants and a healthy litigation market."[136] As the authors of the project recognize, one of the drivers behind conducting the study was that "the amount of money now involved in litigation funding and the number of cases where it is involved … means that some form of regulation or control is now widely perceived as of considerable importance."[137] The project is set to be completed in October 2024, and the organizers hope that the project will, among other things, ultimately "serve as a source of inspiration for legislators considering regulation of TPLF arrangements."[138]

United Kingdom

The United Kingdom (UK) recently took on a similar initiative, with the UK's Civil Justice Council (CJC) announcing that it was conducting a review of TPLF, aiming to get an interim report completed in 2024 and a final report in 2025.[139] While the CJC acknowledges that TPLF (which it refers to as "TPF") in the UK is "currently subject to self-regulation," the review will consider "[t]he background to TPF's development in England and Wales; … [t]he current position concerning self-regulation; [a]pproaches to the regulation of TPF in other jurisdictions," and "[h]ow TPF is located within the broader context of funding options."[140] The CJC hopes to "[s]et out clear recommendations for reform," including "whether and how and, if required, by whom, TPF should be regulated," what "role that rules of court, and the court itself, may play in controlling the conduct of litigation supported by TPF," and considerations of the "[d]uties concerning the provision of TPF, including potential conflicts of interest between funders, legal representatives and funded litigants."[141]

The CJC's efforts have taken on new urgency in light of two recent developments: the UK Supreme Court's July 2023 decision in *PACCAR*

Inc & Ors v Competition Appeal Tribunal & Ors (PACCAR) and the ongoing scandal surrounding the small recoveries received by the 555 sub-postmasters and mistresses wronged by the UK Post Office.

In *PACCAR*, the UK Supreme Court considered whether “litigation funding agreements (‘LFAs’) pursuant to which the funder is entitled to recover a percentage of any damages recovered constitute ‘damages-based agreements’ (‘DBAs’) within the meaning of the relevant statutory scheme of regulation.”[142] The answer to that question posed a serious threat to the TPLF industry in the UK because “[i]f the LFAs at issue … [were] DBAs within the meaning of the relevant legislation, they [would be] unenforceable and unlawful since they did not comply with the formal requirements for such agreements.”[143] Indeed, the Court specifically acknowledged that a finding that LFAs were unenforceable would throw the TPLF industry in the UK into chaos.[144] Nonetheless, by a 4-1 majority, that is exactly what the Court found.[145]

Although the TPLF industry’s allies in Parliament initially tried

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to reverse the *PACCAR* decision through legislation, those efforts appear to have been halted by the UK's recent general election.[146] It remains to be seen whether the new government will be open to a bill reversing *PACCAR*. The new government's appetite for such a bill may well be dampened by the increasing public outrage at the small amount—around £20,000 each—received by the 555 sub-postmasters and mistresses wronged by the British Post Office, in one of the widest miscarriages of justice in UK history.[147] That small recovery was entirely due to the amounts lawyers and litigation funders took out of the settlement fund set up by the Post Office by lawyers and litigation funders.[148] This issue animated the debate on the bill proposed under the last government essentially to reverse the *PACCAR* decision,[149] and it has added even more importance to the results of the Civil Justice Council's work.[150]

In short, policymakers in the EU and the UK are becoming more aware of the problems posed by opaque and unregulated TPLF. The specific reforms that are implemented in the EU and the UK will be shaped by the outcome of the studies being conducted in those two jurisdictions.

With the increased examples of disturbing behavior by funders, it is unsurprising that both courts and lawmakers alike have taken a much greater interest in TPLF over the last several years ...

Conclusion

Chapter

04

TPLF funders have consistently shrouded themselves and their agreements with litigants in secrecy in an effort to protect the myth that they offer beneficial services that come at little cost to the litigants in whose cases they invest. The reality, as the examples just described show, is starkly different.

TPLF funders are not "white knights" or "good Samaritans"; rather, they are opportunistic investors who seek to wring out the greatest amount of profit from cases without regard for the harm it may cause to the litigants whose cases they invest in and who are owed counsel's loyalty. That is perhaps the most pernicious myth of all, that TPLF does not create an ethical quagmire that often results in counsel turning against the very clients to whom they owe their duty of loyalty. And even where a litigation funder's and client's interests are aligned, as in the cases of foreign funders, sometimes those interests could be diametrically opposed to those of the United States and its allies. Indeed, there is increasing evidence that offshore investors may be using TPLF to harm American interests, gain access to information, or even avoid sanctions.

That is why, contrary to the TPLF industry's claims, judges and lawmakers are concerned about the proliferation of litigation funding and why they are increasingly taking action to curb its expansion. Indeed, the many examples outlined above of both American and foreign efforts to regulate, or at the very least, force the TPLF industry into the open should put to rest any claim that decision makers are not concerned about TPLF's apparent and indisputably corrosive effect on the civil justice system. These efforts should be applauded and supported, as without proper attention and regulation, TPLF risks seriously undermining the very access to justice that litigation funders claim to provide.

"That is perhaps the most pernicious myth of all, that TPLF does not create an ethical quagmire that often results in counsel turning against the very clients to whom they owe their duty of loyalty."

Endnotes

[1] Report of the Advisory Committee on Civil Rules at 14 (Dec. 6, 2017), https://www.uscourts.gov/sites/default/files/2017-12-6-civil_rules_committee_report.pdf.

[2] Statera Capital, https://stateracap.com/litigation-finance-services/ ("Statera is a passive investor and does not control your litigation."); Law & Economics Center, Panel 6: *The Evolution of Third-Party Litigation Funding*, Sixteenth Annual Judicial Symposium on Civil Justice Issues (Oct. 10, 2022), https://masonlec.org/events/sixteenth-annual-judicial-symposium-on-civil-justice-issues/ ("I don't know how to say this more clearly, we don't control settlement."); Lesley Stahl, *Litigation Funding: A multibillion-dollar industry for investments in lawsuits with little oversight*, 60 Minutes (Dec. 18, 2022), https://www.cbsnews.com/news/litigation-funding-60-minutes-2022-12-18 (Burford CEO stating that "clients are free to run their litigations as they see fit.... And we don't interfere with that relationship. It's not uncommon for them to come and ask for our advice but it's advice. And the client is free to disregard that advice and take its own path."); Burford, *What we do*, https://www.burfordcapital.com/what-we-do/ (Burford describing itself as "a passive investment partner").

[3] Burford, *What we do*, https://www.burfordcapital.com/what-we-do/.

[4] Burford, *Fees & Expenses*, https://www.burfordcapital.com/what-we-do/fees-expenses/.

[5] Complaint ¶¶ 4, 228, *Sysco Corp. v. Agri Stats, Inc.*, No. 21-cv-1374, ECF No. 1 (D. Minn. filed Mar. 8, 2021); Complaint ¶¶ 2, 346, *Sysco Corp. v. Cargill, Inc.*, No. 22-cv-1750, ECF No. 1 (D. Minn. filed June 24, 2022).

[6] Order (Feb. 9, 2024 *In re Pork* Order) at 6-7, *In re Pork Antitrust Litig.*, No. 18-cv-1776, ECF No. 2104 (D. Minn. Feb. 9, 2024).

[7] Declaration of Patrick C. Swiber, Ex. B at 5, *Glaz LLC v. Sysco Corp.,* No. 1:23-cv-02489, ECF No. 21-2 (S.D.N.Y. filed May 3, 2023).

[8] *See* Amended Petition to Vacate Arbitration Award (Sysco Amended Petition) ¶¶ 30-40, *Sysco Corp. v. Glaz LLC*, No. 1:23-cv-01451, ECF No. 18 (N.D. Ill. filed Mar. 20, 2023).

[9] See *id.* ¶¶ 41-58.

[10] Feb. 9, 2024 *In re Pork* Order at 7.

[11] *Sysco* Amended Petition ¶ 70.

[12] *Id.* ¶ 71.

[13] Feb. 9, 2024 *In re Pork* Order at 9.

[14] *Id.* at 17.

[15] *Id.* at 9.

[16] *Id.* at 9-10.

[17] *Id.* at 17.

[18] Order at 11-12, *Sysco Corp. v. Agri Stats, Inc.*, No. 0:21-cv-01374, ECF No. 41 (D. Minn. June 3, 2024).

[19] See Order, *In re Boiler Chicken Antitrust Litig.*, No. 1:16-cv-08637, ECF No. 7184 (N.D. Ill. Mar. 21, 2024).

[20] *Id.* at 3, 5.

[21] For example, the elaborate funding agreement utilized by Burford in class action litigation against Chevron "provide[d] control to the Funders" through the "installment of 'Nominated Lawyers'"—lawyers "selected by the Claimants with the Funder's approval." Maya Steinitz, *The Litigation Finance Contract*, 54 Wm. & Mary L. Rev. 455, 472 (2012). Similarly, in *Boling v. Prospect Funding Holdings, LLC*, the U.S. Court of Appeals for the Sixth Circuit concluded that the terms of the funding agreements involved in that matter "effectively g[a]ve Prospect [Funding Holdings, LLC (a TPLF entity)] substantial control over the litigation," including terms that "may interfere with or discourage settlement" and otherwise "raise[d] quite reasonable concerns about whether a plaintiff can truly operate independently in litigation." 771 F. App'x 562, 579-80 (6th Cir. 2019). In a lawsuit filed in 2018, White Lilly, LLC, a TPLF entity, affirmatively asserted that it had the contractual right to exercise control over the litigation in which it had invested by, *inter alia*, requiring that specified counsel (who had an existing relationship with the TPLF company) serve as one of the plaintiff's counsel in the funded lawsuit. *See* Compl. ¶ 35, *White Lilly, LLC v. Balestriere PLLC*, No. 1:18-cv-12404 (S.D.N.Y. filed Dec. 31, 2018). And in *Gbarabe v. Chevron Corp.*, the funding agreement contained several key provisions that suggested Therium Litigation Funding IC, a Jersey-based litigation funder, sought to influence the course of the litigation, including one prohibiting the lawyers from engaging any co-counsel or experts without the funder's consent. Litigation Funding Agreement, § 1.1, *Gbarabe v. Chevron Corp.*, No. 14-cv-00173-SI, ECF No. 186-4, 69-91 (N.D. Cal. filed Sept. 16, 2016). Notably, Bentham IMF—now Omni Bridgeway—specifically contemplated funder control over litigation strategies in its 2017 "best practices" guide for U.S. matters, highlighting the importance of setting forth specific terms in TPLF agreements that give the funder authority to:

"[m]anage a litigant's litigation expenses"; "[r]eceive notice of and provide input on any settlement demand and/or offer, and any response"; and participate in settlement decisions. Bentham IMF, Code of Best Practices (Jan. 2017).

[22] Editorial Board, *The Litigation Finance Snare*, The Wall Street Journal, (May 21, 2023), https://www.wsj.com/articles/burford-capital-litigation-financing-sysco-lawsuit-boies-schiller-a4b593fb.

[23] *See generally* Andrew J. Pincus, Archis A. Parasharami, Kevin Ranlett, and Carmen Longoria-Green of Mayer Brown LLP, U.S. Chamber of Commerce Institute of Legal Reform, *Mass Arbitration Shakedown: Coercing Unjustified Settlements* (February 2023), https://instituteforlegalreform.com/wp-content/uploads/2023/02/Mass-Arbitration-Shakedown-digital.pdf.

[24] *See generally* Complaint (Bucher Compl.) ¶ 5, *Bucher v. Zaiger LLC*, No. 3:23-cv-00452, ECF No. 1 (D. Conn. Apr. 10, 2023).

[25] *See generally* Complaint, *Zaiger LLC v. Bucher Law PLLC*, No. 154124/2023, ECF No. 1 (N.Y. Cnty. Sup. Ct. May 9, 2023).

[26] *See generally Valve Corp. v. Bucher Law*, No. 23-2-20447-6 (Wash. Super. Ct. Oct. 20, 2023); *Valve Corp. v. Zaiger LLC*, No. 2:23-cv-01819 (W.D. Wash. Nov. 27, 2023).

[27] Bucher Compl. ¶ 1.

[28] *Id.* ¶ 29.

[29] Affidavit of W. Bucher ¶ 6, *Zaiger LLC v. Bucher Law PLLC*, No. 154124/2023, ECF No. 29 (N.Y. Cnty. Sup. Ct. May 9, 2023).

[30] *Id.*

[31] *Id.*

[32] *Id.* ¶ 10.

[33] *Id.* ¶ 14.

[34] *Id.*, Ex. A, at 5 (32 of 106).

[35] *Id.* at 7 (34 of 106).

[36] *Id.* at 9 (36 of 106).

[37] Bucher Compl. ¶ 52.

[38] *Id.* ¶ 53.

[39] *Id.* ¶¶ 3, 65.

[40] *Id.* ¶ 86.

[41] *Id.* ¶ 107.

[42] *Id.*

[43] *Id.* ¶ 124.

[44] The secrecy surrounding mass arbitrations obscures the full extent of TPLF in these proceedings. *See* J. Maria Glover, *Mass Arbitration*, 74 STAN. L. REV. 1283, 1340 n.296 (2022) ("Because litigation-funding arrangements tend to be confidential, it is not possible to determine whether a particular mass arbitration was funded."). Nonetheless, one professor has explained that the availability of TPLF is directly responsible for the explosion of mass arbitrations:

> The emergence of a multibillion-dollar litigation-funding industry is relevant to the development of mass arbitration in at least three ways. One, third-party funding may well have enabled a number of mass arbitrations, especially at the beginning.[] Two, the availability of third-party funding—nonexistent during the arbitration revolution—made mass arbitration a more realistic possibility for firms that needed (or wished) to hedge against the model's substantial risks. Three, third-party litigation-funding arrangements are more available for individualized claiming models like mass arbitration than they are for class-action suits. []

Id. at 1340 (citations omitted).

[45] *See generally* Michael E. Leiter, John H. Beisner, Jordan M. Schwartz and James E. Perry of Skadden, Arps, Slate, Meagher & Flom LLP, U.S. Chamber of Commerce Institute of Legal Reform, *ILR Briefly*, *A New Threat: The National Security Risk of Third Party Litigation Funding* (November 2022) (A New Threat), https://instituteforlegalreform.com/research/ilr-briefly-a-new-threat-the-national-security-risk-of-third-party-litigation-funding/.

[46] Letter, U.S. Senators John Cornyn & Thom Tillis (July 11, 2024) (Sens. Cornyn-Tillis Letter), https://www.cornyn.senate.gov/wp-content/uploads/2024/07/7.11.24-TPLF-Letter.pdf.

[47] *Id.*

[48] Press Release, U.S. Senator Marco Rubio, *Rubio, Scott Push for Transparency for Foreign Third Party Litigation Funding in U.S. Courts* (Nov. 3, 2023) (Sen. Rubio Release), https://www.rubio.senate.gov/rubio-scott-push-for-transparency-for-foreign-third-party-litigation-funding-in-u-s-courts/.

[49] *See id.*

[50] *See id.*

[51] House Select Committee on the Strategic Competition Between the United States and the Chinese Communist Party, *Reset, Prevent, Build: A Strategy to Win America's Economic Competition with the Chinese Communist Party* (Dec. 12,

2023), at 21, https://selectcommitteeontheccp.house.gov/sites/evo-subsites/selectcommitteeontheccp.house.gov/files/evo-media-document/reset-prevent-build-scc-report.pdf.

[52] *Id.*

[53] *See generally* Hon. Christopher Carr (GA), Hon. Jason Miyares (VA), *et al.*, Letter to U.S. DOJ re: Threats Posed by Third-Party Litigation Funding (Carr 12/22/22 Letter) (Dec. 22, 2022), https://www.tn.gov/content/dam/tn/attorneygeneral/documents/pr/2022/pr22-55-letter.pdf.

[54] *See generally* R. Kelner, B. Smith, A. Langton, Law360, *DOJ Officials' Remarks Signal New Trends In FARA Activity* (December 14, 2023), https://www.law360.com/articles/1776917/doj-officials-remarks-signal-new-trends-in-fara-activity.

[55] *Id.*

[56] *Id.*

[57] Maya Steinitz, *Whose Claim Is This Anyway? Third-Party Litigation Funding*, 95 Minn. L. Rev. 1268, 1270 (2011).

[58] Press Release, U.S. Senator John Kennedy, *Kennedy Urges Roberts, Garland to Take Action to Protect National Security From Foreign Actors Meddling in U.S. Courts* (Jan. 9, 2023), https://www.kennedy.senate.gov/public/press-releases?ID=1FBC312C-94B8-409B-B0A3-859A9F35B9F5; Letter from Sen. John Kennedy to Honorable Merrick Garland & Honorable John Roberts (Jan. 6, 2023), https://www.kennedy.senate.gov/public/_cache/files/0/7/077acc52-6622-453b-b9a5-bbecd358e136/32C50A661400A5B670DC1D48B8D75E73.letter-to-ag-garland-cheif-justice-roberts.pdf.

[59] GAO, Report to Congressional Requesters, Third-Party Litigation Financing, Market Characteristics, Data, and Trends, at 10 & n.24 (Dec. 2022), https://www.gao.gov/assets/gao-23-105210.pdf. For example, in its 2023 shareholder newsletter, Burford reported that "our partnership with our sovereign wealth partner … provided 88% of our Burford-only asset management income in 2023." *See* Burford Capital 2023 Shareholder Letter at VI, https://s201.q4cdn.com/169052615/files/doc_financials/2023/q4/2024-03-14-Burford-Capital-2023-Shareholder-Letter-FINAL-1447611-1.pdf. Burford also boasted that it has extended the size and duration of its partnership with this unnamed foreign funder. *See Burford Capital expands and further extends sovereign wealth fund arrangement*, (Nov. 9, 2023), https://www.burfordcapital.com/insights-news-events/news-press-releases/burford-capital-expands-and-further-extends-sovereign-wealth-fund-arrangement/.

[60] Emily R. Siegel & John Holland, *Putin's Billionaires Dodge Sanctions by Financing Lawsuits*, Bloomberg Law (Mar. 28, 2024), https://news.bloomberglaw.com/litigation-finance/putins-billionaires-sidestep-sanctions-by-financing-lawsuits.

[61] *Id.*

[62] Emily R. Siegel, *UK Judge Rules Funder is Likely Owned by Sanctioned Russians*, Bloomberg Law (May 7, 2024), https://news.bloomberglaw.com/business-and-practice/uk-judge-rules-funder-is-likely-owned-by-sanctioned-russians.

[63] *Vneshprombank LLC v. Bedzhamov* [2024] EWHC (Ch) 1048 [3-4].

[64] *Vneshprombank LLC v. Bedzhamov* [2024] EWHC (Ch) 1048 [4]; Emily R. Siegel, *UK Judge Rules Funder is Likely Owned by Sanctioned Russians*, Bloomberg Law (May 7, 2024), https://news.bloomberglaw.com/business-and-practice/uk-judge-rules-funder-is-likely-owned-by-sanctioned-russians.

[65] An Update from the Treasury Department: Countering Illicit Finance, Terrorism and Sanctions Evasion: Hearing Before Senate Comm. on Banking, Housing, and Urban Affairs, 118 Cong. (April 9, 2024) (Testimony of W. Adeyemo); Emily R. Siegel, *UK Judge Rules Funder is Likely Owned by Sanctioned Russians*, Bloomberg Law (May 7, 2024), https://news.bloomberglaw.com/business-and-practice/uk-judge-rules-funder-is-likely-owned-by-sanctioned-russians.

[66] Emily R. Siegel & John Holland, *Putin's Billionaires Dodge Sanctions by Financing Lawsuits*, Bloomberg Law (Mar. 28, 2024), https://news.bloomberglaw.com/litigation-finance/putins-billionaires-sidestep-sanctions-by-financing-lawsuits.

[67] Emily R. Siegel, *China Firm Funds US Suits Amid Push to Disclose Foreign Ties*, Bloomberg Law (Nov. 6, 2023), https://news.bloomberglaw.com/business-and-practice/china-firm-funds-us-lawsuits-amid-push-to-disclose-foreign-ties; https://www.purplevineip.com/en/.

[68] *See* Plaintiff's Statement Regarding Third-Party Litigation Funding Arrangements, *Staton Techiya, LLC v. Harman Int'l Indus., Inc.*, No. 1:23-cv-00801-JCG, ECF No. 7 (D. Del. Aug. 24, 2023).

[69] *See* Samsung's Motion for Leave to Amend Answer & Counterclaims to Join Purplevine and PV Law as Counterclaims Defendants at 6, *Staton Techiya, LLC v. Samsung Elecs. Co.*, No. 2:23-cv-00319-JRG-RSP, ECF No. 65 (E.D. Tex. June 13, 2023).

[70] *See id.* at 5-6.

[71] *Id.* at 7.

[72] *Id.* at 9.

[73] *Id.* at 7, 11.

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

[75] *Id.* at 15.

[76] *See generally* Complaint, *Staton Techiya, LLC v. Harman Int'l Indus., Inc.*, No. 1:23-cv-00801-JCG, ECF No. 1 (D. Del. July 25, 2023).

[77] Michael B. Mukasey, *Patent Litigation Is a Matter of National Security*, Wall Street Journal, (Sept. 11, 2022), https://www.wsj.com/articles/patent-litigation-is-a-matter-of-national-security-chips-and-science-act-intellectual-property-theft-lawsuit-technology-scammers-manufacturing-11662912581. The Mukasey op-ed specifically addresses patent infringement initiated by VLSI Technology LLC, which is beneficially owned by numerous entities, including sovereign wealth funds such as Fortress Investment Group (FIG). *See id.*; *see also* Mem. Order, *VLSI Tech. LLC v. Intel Corp.*, C.A. No. 18-966-CFC-CJB, ECF No. 975 (D. Del. Aug. 1, 2022). Notably, FIG was recently acquired by Mubadala, an Abu Dhabi-owned sovereign wealth fund. See https://www.bloomberg.com/news/articles/2022-09-06/abu-dhabi-s-mubadala-said-to-near-2-billion-deal-for-fortress. Mubadala also happens to be the largest owner of Global Foundries, a chip manufacturer. These circumstances illustrate the web of foreign connections and raise serious questions about whether the sources of funding for lawsuits in the United States are either directly or indirectly competitors of American companies engaged in sensitive industries.

[78] *See* A New Threat, *supra* note 45, at 11.

[79] Robert Freedman, *Litigation Funding Seen as Strategic Tool for Pursuing Lawsuits*, Legal Dive (July 1, 2022), https://www.legaldive.com/news/litigation-funding-seen-as-strategic-tool-for-pursuing-lawsuits/626488/.

[80] MacroMicro, US - High-Yield Bond Effective Yield, https://en.macromicro.me/collections/9/us-market-relative/117/us-junk-bonds-yield (last visited July 12, 2024).

[81] Memorandum Order at 1, *Arigna Tech. Ltd. v. Longford Cap. Fund III, LP*, No. 1:23-01441-GBW, ECF No. 56 (D. Del. June 5, 2024).

[82] *Id.*

[83] *Id.*

[84] *Id.*

[85] *Id.* at 3.

[86] *Id.*

[87] *Id.*

[88] *Id.*

[89] *Id.*

[90] *Id.* at 4.

[91] *Id.*

[92] *See generally id.*

[93] The Arigna debacle also illustrates another danger posed by TPLF agreements: the risk that clients may be deprived of their counsel of choice when they attempt to push back against an aggressive litigation funder. Specifically, just two days after the District of Delaware granted Longford's motion to compel arbitration to adjudicate the scope of its entitlement to Arigna's settlement, the District Court for the District of Columbia granted Susman's motion to withdraw as counsel for Arigna in a different case after concluding that Susman could be forced "to choose between preparing to sue Arigna on the one hand and zealously advocating for Arigna on the other" in connection with the Longford arbitration. *See* Mem. Op. at 8, *Bayerische Motoren Werke AG v. Arigna Tech. Ltd.,* No. 1:23-cv-01190-RC, ECF No. 59 (D.D.C.). Specifically, the court noted that because Susman and Arigna "appear to be at an impasse with respect to whether the representation agreement [between them] requires Arigna to indemnify and advance defense costs to Susman for the LCF arbitration, there is at least the specter that Susman will sue Arigna." *Id.* For that reason, the court found that it was "in the interests of justice to permit Susman to withdraw as counsel in [the] case." *Id.* Thus, even if Longford ultimately fails to collect from Arigna's settlement, it has at the very least deprived Arigna of its counsel of choice to pursue the patent enforcement campaign.

[94] Case Mgmt. Order No. 61 at 3, *In re 3M Combat Arms Earplug Prods. Liab. Litig.*, No. 3:19-md-02885-MCR-HTC, ECF No. 3815 (N.D. Fla. Aug. 29, 2023).

[95] *Id.* at 1, 3.

[96] *Id.* at 1.

[97] *Id.* at 3.

[98] *Id.*

[99] *Id.*

[100] Sens. Cornyn-Tillis Letter, at 1.

[101] Brenna Goth, *Third-Party Funding for Litigation Faces States' Scrutiny,* Bloomberg Government, (Aug. 5, 2024), https://news.bgov.com/bloomberg-government-news/third-party-funding-for-litigation-comes-under-states-scrutiny.

[102] *See* D.N.J. L. Civ. R. 7.1.1(a).

[103] *Id*.

[104] Standing Order for All Judges of the Northern District of California (Nov. 1, 2018).

[105] *See* Standing Order Regarding Third-Party Litigation Funding Arrangements, https://www.ded.uscourts.gov/sites/ded/files/Standing%20Order%20Regarding%20Third-Party%20Litigation%20Funding.pdf.

[106] Hr'g Tr. 12:21-24, *In re Soc. Media Adolescent Addiction/Pers. Injury Prods. Liab. Litig*., MDL No. 3047 (N.D. Cal. Nov. 9, 2022) ("I want to know explicitly whether you use [TPLF] or intend to use it in this case.").

[107] *See In re Nat'l Prescription Opiate Litig*., No. 1:17-MD-2804, 2018 WL 2127807, at *1 (N.D. Ohio May 7, 2018).

[108] *See* Rule 26(f) Report of the Parties, Standing Orders, Judge J. Philip Calabrese (N.D. Ohio), https://www.ohnd.uscourts.gov/sites/ohnd/files/Rule%2026%28f%29%20Report%20of%20the%20Parties%20%281.2.2024%29.pdf.

[109] *See* Case Mgmt. Order Regarding Model Leadership Appls. for Consumer Track at 2-3, *In re Marriott Int'l Customer Data Sec. Breach Litig*., MDL No. 19-md-2879, ECF No. 171 (D. Md. filed Apr. 11, 2019).

[110] Document No. 17-CV-O, as supplemented by letter dated November 3, 2017, Document No. 17-CV-GGGGGG.

[111] *See generally* Sen. Rubio Release.

[112] Letter from Rep. James Comer to Honorable John Roberts (July 12, 2024).

[113] Emily R. Siegel, *Comer Urges Chief Justice Roberts to Examine Litigation Funding*, Bloomberg Law (July 12, 2024), https://news.bloomberglaw.com/business-and-practice/comer-urges-chief-justice-roberts-to-examine-litigation-funding.

[114] *See generally* Sens. Cornyn-Tillis Letter.

[115] *Id.*

[116] The U.S. Intellectual Property System and the Impact of Litigation Financed by Third-Party Investors and Foreign Entities: Hearing Before the Subcommittee on Courts, Intellectual Property, and the Internet, 118 Cong. (June 12, 2024).

[117] *See* Press Release, Representative Darrell Issa, *Issa Introduces Discussion Draft of Legislation Reforming Third-Party Financed Civil Litigation* (July 11, 2024), https://issa.house.gov/media/press-releases/issa-introduces-discussion-draft-legislation-reforming-third-party-financed.

[118] At the time of publication, the bill's sponsors were seeking to include its provisions as an amendment to the National Defense Authorization Act for 2025. *See* S.A. 2333 – 118th Congress (2023-2024): Protecting Our Courts From Foreign Manipulation, Amendment to S. 4638, 118th Cong. (July 11, 2024), https://www.congress.gov/118/crec/2024/07/11/170/115/CREC-2024-07-11-pt1-PgS4667-4.pdf.

[119] Press Release, *Senator Kennedy, Kennedy, Manchin Introduce Bipartisan Protecting Our Courts from Foreign Manipulation Act to End Overseas Meddling in U.S. Litigation* (Sept. 14, 2023), https://www.kennedy.senate.gov/public/2023/9/kennedy-manchin-introduce-bipartisan-protecting-our-courts-from-foreign-manipulation-act-to-end-overseas-meddling-in-u-s-litigation.

[120] 2017 Wis. Act 235, https://docs.legis.wisconsin.gov/2017/related/acts/235.

[121] W. Va. Code Ann. § 46A-6N-6 (enacted 2019).

[122] S.B. 850, 2024 Reg. Sess. (W.V. Mar. 9, 2024) (signed Mar. 27, 2024).

[123] See MT LEGIS 360 (2023), 2023 Montana Laws Ch. 360 (S.B. 269) (enacted 2023).

[124] IN LEGIS 63-2023 (2023), 2023 Ind. Legis. Serv. P.L. 63-2023 (H.E.A. 1124) (enacted 2023).

[125] Ind. Code § 24-12-1.05, et. seq.

[126] Mark Popolizio, *Louisiana Enacts New Third-Party Litigation Funding (TPLF) Law*, Verisk (June 27, 2024), https://www.verisk.com/blog/louisiana-enacts-new-third-party-litigation-funding-tplf-law/.

[127] *See generally* https://legis.la.gov/legis/ViewDocument.aspx?d=1382655.

[128] An EU "'directive' is a legislative act that sets out a goal that EU countries must achieve. However, it is up to the individual countries to devise their own laws on how to reach these goals." EU, *Types of Legislation,* https://european-union.europa.eu/institutions-law-budget/law/types-legislation_en.

[129] *See generally* Report A9-0218/2022, *REPORT with recommendations to the Commission on Responsible private funding of litigation, Committee on Legal Affairs,* European Parliament (July 25, 2022), https://www.europarl.europa.eu/doceo/document/A-9-2022-0218_EN.html#_section5.

[130] *Id*. at Annex to The Motion For a Resolution: Recommendations as to the Content of The Proposal Requested, ¶ 9.

[131] *Id.* at Introduction point 3.

[132] *See generally*, Report A9-0218/2022.

[133] *See* Texts Adopted, *Responsible private funding of litigation,* European Parliament (September 13, 2022), https://www.europarl.europa.eu/doceo/document/TA-9-2022-0308_EN.html.

[134] *See generally* British Institute of International and Comparative Law, *Projects: Mapping Third Party Litigation Funding in the European Union,* https://www.biicl.org/projects/mapping-third-party-litigation-funding-in-the-european-union.

[135] In addition to these efforts, the EU Directive on Representative Actions (RAD) includes additional safeguards for funding, all related to the "qualified entity" bringing the claim. The text of the RAD states that a qualified entity should be independent and not influenced by third parties, including litigation funders, and that it should have measures in place to prevent conflicts of interest between itself, its funding providers, and the interests of consumers. The qualified entity must also disclose to the court the sources of funding for a particular representative action. The RAD empowers courts or administrative authorities in the Member States to require the qualified entity to refuse or make changes to the funding agreement. *See* RAD Art. 4, 10, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32020L1828. Pursuant to the authority given to Member States by the RAD, certain Member States have put in place additional restrictions on TPLF. For example, Czechia, Germany, and Portugal have added additional transparency measures for TPLF to their legislation implementing the RAD, and the practice has been banned in class actions in Greece and Ireland.

[136] European Law Institute, *ELI Third Party Funding of Litigation*, https://www.europeanlawinstitute.eu/projects-publications/current-projects/current-projects/eli-third-party-funding-of-litigation/.

[137] *Id.*

[138] *Id.*

[139] UK Courts and Tribunals Judiciary, *Litigation Funding*, https://www.judiciary.uk/related-offices-and-bodies/advisory-bodies/cjc/current-work/third-party-funding/.

[140] *Id.*

[141] *Id.*

[142] *R (on the application of PACCAR Inc and others) (Appellants) v. Competition Appeal Tribunal and others (Respondents)*, 2023 UKSC 28, ¶ 3, https://www.supremecourt.uk/cases/docs/uksc-2021-0078-judgment.pdf.

[143] *Id.*

[144] *Id.* ¶ 13.

[145] *Id.* ¶¶ 95-99.

[146] Robert Li, *UK Election Stymies Anti-PACCAR Bill*, CDR (May 24, 2024), https://www.cdr-news.com/categories/third-party-funding/20717-uk-election-stymies-anti-paccar-bill.

[147] Ben Rigby & John Malpas, *The Post Office Scandal's Far-Reaching Impact on Litigation Funding*, Global Legal Post (May 3, 2024), https://www.globallegalpost.com/news/the-post-office-scandals-far-reaching-impact-on-litigation-funding-2128628694. The scandal, in which more than 900 sub-postmasters were prosecuted for stealing due to a software malfunction, has been widely covered by the British Press. *See, e.g., Post Office Horizon Scandal: Why Hundreds Were Wrongly Prosecuted*, BBC (May 24, 2024), https://www.bbc.com/news/business-56718036.

[148] *Id.*

[149] *Id.*

[150] *See generally* Fair Civil Justice*, Establishing Fairness in Litigation Funding: A British Roadmap to Protect Consumers, SMEs and Other Parties in Funded Legal Actions* (June 24, 2024). https://fairciviljustice.org/wp-content/uploads/2024/06/1452C_TPLF_4_RGB_Pages.pdf.

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Ranking Member Jamie Raskin
Committee on Oversight and Accountability
Hearing on "Unsuitable Litigation: Oversight of Third-Party Litigation Funding"
September 13, 2023

Thank you, Chairman Comer, and thank you to our witnesses for being here today.

All over America, people are in an uproar over the money that billionaires and big corporations are spending to influence individual Justices on the Supreme Court. Americans see that personal gifts to Justices from right-wing billionaire sugar daddies like Harlan Crow and Federalist Society dark money expenditures are fundamentally perverting judicial ethics and undermining justice and the rule of law.

Apparently responding to the national outcry over this ethics crisis on the Supreme Court, our colleagues have called a hearing today about the influence that wealth exerts on the justice system, but they have gone off on a surprising and bizarre tangent. **The problem, Republicans say, is not the way the public is harmed when right-wing billionaires bankroll the private lives of ethically-challenged Supreme Court Justices. The real problem is that giant corporations are harmed when Americans injured by toxic torts or environmental crimes receive contributions from liberal donors to help them bring personal injury or class action lawsuits.**

In other words, while Supreme Court Justices are jetting all over the world on fancy private family vacations paid for by billionaires or collecting hefty cash gifts from billionaires for their personal museums and family members' private school tuition payments, the GOP says the key problem in our legal system is that too many victims of corporate wrongdoing are finding access to the courts at all.

We say "justice is blind" because the Greek statue for Justice wears a blindfold; in solving cases, judges are supposed to be blind to wealth and poverty, personal friendship and party affiliation.

A poor person who has never met a judge must be treated the same by the courts as Harlan Crow, the real estate tycoon billionaire chum of Justice and Mrs. Clarence Thomas who had a case before the Supreme Court and who has given the Thomases lavish personal gifts, like week-long luxury travel on his super-yacht and private jets, and generous money payments for family tuition over a period of 20 years ever since Thomas joined the Court. A collector of not-so-fine art created by dictators who actually owns and displays two paintings done by Adolph Hitler, Mr. Crow donated $105,000 to the Yale Law School in 2018 for another painting he desires, writing a check to the "Justice Thomas Portrait Fund."

Justice Thomas is not unique. He is just emblematic of the collapse of ethics across the street. Justice Alito took a long fishing trip with a hedge fund magnate who has had business before the Supreme Court 10 times in the last fifteen years. Neither Justice recused himself in the relevant cases or made any relevant timely disclosures.

Justice is supposed to be blind to the blandishments of money and class power. It is only supposed to see the facts and the law. But, in the Roberts Court, judicial vision is clouded everywhere by dollar signs and luxury power trips. The facts and the law are barely visible when it comes to the rights of hourly workers trying to organize a union, poor women seeking abortions or consumers injured by adhesion contracts and corporate ripoffs. Justice is a rich man's game in this Court of billionaires and right-wing ideologues. The Bill of Rights has mostly been left in the dust.

On the Roberts Court, justice is indeed blind but only to ethics itself; it is deaf to the pleas of women and working people; and it is dumb in its refusal to see how it has destroyed its own legitimacy. It is certainly not mute as Justices Alito and Thomas vociferously defend their jet-setting lifestyles in shockingly intemperate and political terms.

If we are going to return to "equal justice under law," as it is written over the entrance to the Supreme Court, if we are to make justice blind to the wealth and connections of the parties in the courtroom, then our justices must be held to the highest ethical standards.

Yet, amazingly, the Justices are not even subject to the basic Code of Conduct for United States Judges that all other federal judges are subject to. The nine Justices are, in fact, not bound by any ethical standards at all, much less the comprehensive ethics code that applies to every other judge in the federal and state judicial system.

Their decisions can affect or destroy the rights of all Americans, but the Justices refuse to abide by any written ethical code. They decide on their own if their work is impaired by a real or apparent conflict of interest, a terrible system which cuts against the cardinal principle of justice articulated by James Madison in the Federalist Papers: "No man is allowed to be a judge in his own cause[.]"

The highest court in our land has the lowest ethical standards. This is the crisis that Congress should be discussing today. But our colleagues have instead called a hearing to assert that it's just too easy to haul big corporations into court when they violate other Americans' rights to health, safety, property, and environmental quality. The third-party litigation funding under attack today is the only way that a lot of victims of corporate misconduct and negligence can even get into court. Do our colleagues really want to make it illegal to receive contributions to vindicate your rights?

I could understand if they were saying that all the present federal rules of civil procedure against frivolous, vexatious and groundless litigation weren't working and needed to be toughened up. I could understand if they were arguing that Rule 11 sanctions against baseless lawsuits needed to be expanded or fortified.

But that's not what they're arguing. They're not citing any kind of increase in frivolous or meritless litigation nor are they arguing that current sanctions don't work to deter frivolous lawsuits. Those sanctions are working just fine. No, they're looking for ways to reduce the prosecution of merit worthy and successful lawsuits against corporate wrongdoers.

By pulling the rug out from underneath actual tort victims, they hope to keep plaintiffs from even getting into court. **The GOP wants to dramatically reduce accountability and liability for corporations that flood our country with opioids to make obscene profits, corporations that poison our communities with asbestos or lead and other dangerous carcinogens; and corporations that inflict black lung disease, mass oil spills and other lethal injuries on American workers and their families.**

Our colleagues seem confused. No one has a right to bribe judges or load them up with fancy gratuities, but people do have every First Amendment, Due Process and Equal Protection right to raise money to make their case in court. The courts are not just there for rich people who can write themselves a check. This is the same reason people have a right to give and receive campaign contributions, for public office is not just for the independently wealthy.

Victims bringing these lawsuits, especially those who are low-income or unable to work because they are injured or sick, often could not afford to bring the lawsuits at all without financial help from other citizens. If their lawsuits have no merit, they will be thrown out, but if they have merit, then we should all be grateful they are working to make society safer by stopping and penalizing the wrongdoers before they commit more wrongs against society.

Many landmark cases establishing the basic rights of Americans were funded by contributions from outside groups. Cases like *Brown v. Board of Education*, *Loving v. Virginia*, which struck down Jim Crow anti-miscegenation laws and upheld the right to marry who you want, and *U.S. v. Windsor*, which upheld the rights of same-sex marriage.

The corporate interests represented on the panel today who are attacking this basic right are here for an obvious reason. They don't like paying damages when their victims prove their rights have been violated in court.

Johnson & Johnson has had to pay billions of dollars for its central role in the opioid epidemic and billions more to tens of thousands of people who developed cancer because of the company's dangerous talcum powder.

Mining and offshore drilling companies have had to pay billions of dollars for poisoning communities, land, and water and causing irreparable harm to human health. Perhaps one of the largest environmental cases in the history United States, oil company BP agreed to pay nearly $20 billion for damages cause by the Deepwater Horizon oil spill in Gulf of Mexico. In 2011, Hecla Mining Company agreed to pay over $260 million for damages to natural resources in Idaho caused by millions of tons of mining waste being released into local rivers. There are countless other examples of personal and environmental harm caused by these companies that have been partially rectified by litigation.

One can only regard with amazement the fact that our colleagues are in such a hurry to promote the self-pitying grievances of these wealthy tortfeasors and wrongdoers that they do not even pause to consider that there are hundreds of millions of dollars in right-wing third-party litigation financing which regularly bankrolls anti-choice, anti-LGBTQ, and anti-gun safety lawsuits, among others.

Well-funded right-wing networks like the Pacific Legal Foundation, the Koch network, and the Judicial Crisis Network have poured hundreds of millions into remaking America through the courts on issues ranging from attacking the curriculum in local public schools to opposing compulsory union dues to repealing the Consumer Financial Protection Bureau.

The Alliance Defending Freedom and other right-wing groups brought the Dobbs case and are working to completely eliminate access to abortion for all Americans. Our colleagues don‘t complain about that and they don't even mention it. Are they willing to sacrifice the rights of these third-party litigation financiers on the Right or are they just not serious about this whole thing and simply looking for another catchy way to distract everyone from Donald Trump's 91 different criminal charges in four separate prosecutions? Is this whole hearing a bunch of hooey?

Everyone knows that a fish rots from the head down, and everyone knows what stinks to the high heavens in the judicial system is, alas, the Supreme Court itself. Let's focus on where the corruption of justice is really taking place.

Thank you. I yield back.

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15 U. Pa. J. Bus. L. 1075

University of Pennsylvania Journal of Business Law
Summer, 2013

Article

David S. Abrams, Daniel L. Chen[a1]

A MARKET FOR JUSTICE: A FIRST EMPIRICAL LOOK AT THIRD PARTY LITIGATION FUNDING

Abstract

The alienability of legal claims holds the promise of increasing access to justice and fostering development of the law. While much theoretical work points to this possibility, no empirical work has investigated the claims, largely due to the rarity of trading in legal claims in modern systems of law. In this paper we take the first step toward empirically testing some of these theoretical claims using data from Australia. We find some evidence that third-party funding corresponds to an increase in litigation and court caseloads. Cases with third-party funders are more prominent than comparable ones. While third-party funding may have effects on both the cases funded and the courts in jurisdictions where it is most heavily used, the overall welfare effects are ambiguous.

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The primary argument for markets is that they increase overall welfare by allocating goods and services where they are most valued.[1] Market forces can provide a powerful disciplinary effect on human behavior and the production of goods and services. Yet we don't see markets form everywhere. This paper deals with one missing marking in particular: the market for litigation.

Suppose we allow individuals the right to trade litigation claims,[2] thereby creating a market for justice. This could be a market-based solution to the undersupply of some types of litigation. Would such a market spur innovation, increase settlement rates, and avoid taint?[3]

Selling litigation rights to parties with the resources to pursue the claims may address the problem of litigation undersupply due to credit constraints, risk aversion, collective action problems, or simply unawareness, even when a plaintiff or defendant has a positive expected payoff. A market for litigation should lead initially to more litigation, thereby clarifying disputes earlier. This could have large positive externalities, as future actors would have greater certainty about the law and therefore could make better-informed decisions. While government subsidies in the form of legal aid partially address these issues,[4] a market for justice has the potential to have a much greater impact.

This paper makes the first attempt to quantify empirically the effects of a third-party litigation funding system. Using data from the leading Australian litigation-funding firm and Australian courts, we examine the impact of litigation funding on courts and on cases that receive funding. ***1077** The empirical strategy compares the outcomes in Australian states where litigation-funding firms are active to the outcomes in areas where they are not active.

Undersupply of litigation funding may result from several sources. Credit-constrained individuals or firms may have positive expected-value litigation claims, but be unable to pursue them due to lack of funds.[5] Allowing third-party funders to buy a claim or a fraction thereof could allow a case to proceed where it would not have previously.[6] The claims pursued with such financing would tend to be more costly and be brought by less-wealthy individuals or firms.[7]

Risk-averse individuals or firms will also eschew pursuit of positive expected-value claims, but not necessarily due to cost considerations. The uncertainty inherent in legal proceedings will reduce the value relative to a risk-neutral entity.[8] Thus, the transfer of a claim from a risk-averse to a risk-neutral party should yield an increase in total claims pursued. The transferred claims would be riskier and be brought by more risk-averse entities.[9]

There are other contexts in which third-party funding or litigation trading could affect the claims pursued. For example, multiple parties that share a claim in complex cases may face a collective action problem: while ***1078** individually the case is not worth pursuing, it would be worth pursuing if all the benefits accrued to one party.[10] Allowing the trading of claims makes it possible for this transfer of benefits to proceed.

One further group that could benefit from litigation trading consists of individuals and firms unaware that they possess a legal claim. If information about the legal system is imperfect,[11] there will be entities that fall into this category. The ability of third parties to benefit in some way from the prospective resolution of claims creates an incentive to locate and provide information to otherwise unaware claim holders.

Litigation trading is not the only way to address the failure to pursue positive expected-value claims. In some legal systems, including the United States', contingency fees partially serve this purpose by lowering or eliminating entry costs for clients in addition to dispersing some of the risk of litigation.[12] There are some important differences between contingency ***1079** fees and litigation trading, however. The most prominent difference is that the potential funder in the contingency fee system must be an attorney.[13] This can lead to some less desirable outcomes relative to litigation trading. For example, limiting potential funders to attorneys necessarily restricts the liquidity of the market for litigation, meaning that some positive expectation claims still may not be pursued because of an inability to find financing. It also may skew the claims that do get funded in favor of those that fit the risk profile of litigators. Many contingency-fee attorneys are unlikely to work on cases that have a low chance of success, even if the expected value is high.[14] The contingency fee system also ends up imposing a large cost on clients, usually in the range of thirty percent--an amount that could be substantially decreased in a more competitive market for funding.[15]

At the introduction of a rule allowing litigation trading, one would expect an increase in initial legal claims from the credit-constrained, the risk-averse, and the previously ill-informed.[16] Whether this would translate into an overall increase in litigation, however, is unclear. One would expect the introduction of a third-party funder to alleviate the problem of skewed settlements resulting from a risk-averse, one-off plaintiff engaging with a large defendant able to absorb and spread the cost.[17] This would ***1080** lead to an increase in settlement rates as defendants adapted to the involvement of third-party funders.[18]

The overall welfare effects of introducing third-party funding into a legal system are also ambiguous. While benefits to several groups have been mentioned, they are not comprehensive. For example, an additional benefit of litigation trading may be clarification of the law. Should litigation trading increase, one would expect to not only see an increase in resources expended on litigation in general, but also a diversification of plaintiffs and claims. [19] Consequently, previously unaddressed legal questions would arise and be resolved more quickly. This would lead to more efficient behaviors as parties make better-informed decisions.

There are also potential costs of allowing litigation trading. Legal prohibitions against maintenance, the practice of a party "without interest" in a suit assisting in litigation, and champerty, receiving a share of the proceeds of a suit, were intended to prevent the perversion of justice. [20] The concerns voiced by courts over these early forms of third-party funding could plague modern litigation claim-trading systems as well. Another concern is that a rule change could lead to a vast increase in litigation with low social value, which would in turn congest the courts and divert their resources from more socially valuable litigation.

In this paper, we aim to add to the discussion of whether and to what extent third-party litigation funding should be available by providing the first empirical evidence relevant to these considerations. Effects on aggregate welfare are always difficult to measure convincingly, and we cannot do so directly here. This would require a great deal of detailed information on all manner of claims brought, most of which end in settlement. [21] Settlement data is notoriously difficult to collect, as its ***1081** reporting is not required except in very limited circumstances. [22] However, by empirically examining the first major implementation of a third-party funding system, we are able to shed some light on the central questions.

Specifically, we collect data from Australian courts, administrative agencies, and the largest third-party litigation funding firm in Australia, IMF (Australia) Ltd. [23] Using this data, we take two approaches to understanding the impact of third-party funding on various outcomes. First, we use IMF's entry into an Australian state as a proxy for the relaxing of rules against third-party funders. Using court data, we can examine the effects of the rule change on the processing and expense of litigation in the courts. We attempt to control for overall time trends and state-specific differences by using criminal data as a control, since third-party funding is only available in civil litigation. We find that third-party funding does appear to be associated with increased expense to the courts, an increased backlog, and an increase in average case duration. [24]

Second, we use a case study methodology to examine a handful of published cases considered by IMF, some of which were funded and some of which were not. By examining all cases considered by IMF and not just funded cases, we attempt to eliminate some of the selection bias inherent in the process of choosing cases for funding. [25] Here, we find a difference in the impact of cases that were funded from those that were not. The funded cases cite substantially more cases than unfunded ones, and are themselves cited over twice as frequently. This evidence supports the notion that third-party funding can spur the development of law.

The past several years have seen a major downturn in the market for legal services. [26] New technologies are allowing the outsourcing of more legal matters, and firms are becoming increasingly global. [27] As such, many ***1082** countries around the world are reconsidering restrictions on various legal practices that would allow for, among other things, law firms to be publicly traded, firms to take on non-attorney partners, and litigation to be funded by third parties. [28] In this paper, we hope to add some empirical evidence to help inform policy discussions in the last category.

The remainder of this paper is organized as follows. First, we provide some of the history behind prohibitions on third party funding and its evolution, and then discuss in detail how litigation funding works in Australia. We then introduce a new model of the potential impact of litigation funding. Next, we present empirical specifications and data sources, followed by our main empirical results. This is followed by an exploration of the limitations of these findings, and then concluding remarks.

I. Background

Prohibitions on third-party involvement in litigation have a medieval origin.[29] During this era in England, coercive litigation was used by wealthy landowners as a means to obtain more land.[30] This often took the form of funding litigation by third parties with the express goal of acquiring more land at below-market prices.[31] This eventually led to a response by the legislature, which passed a number of statutes that included prohibitions on maintenance and champerty.[32]

These prohibitions remained in effect in several common law jurisdictions through today.[33] As legal systems have become more ***1083** formalized and less prone to outside corruption, the rationale for these doctrines has waned. Many jurisdictions have abolished maintenance and champerty as torts,[34] and England abandoned them in 1967 with the Criminal Law Act.[35] In Australia a number of states have abolished prohibitions on maintenance and champerty, including New South Wales, Australian Capital Territory, Victoria, and South Australia.[36] In the United States, although there have been few prosecutions for maintenance or champerty in the last century,[37] the legal theories underlying the doctrines are still considered valid.[38] In recent years, Australia has abandoned prohibitions on champerty and maintenance.[39]

Third-party litigation funding provides financial support for litigation by an entity that is not a party to the litigation and with no direct interest in the outcome. It is therefore a direct violation of the doctrine of maintenance. Historically, third-party litigation funding has been tolerated in some contexts, such as the disposition by liquidators[40] or trustees[41] in ***1084** bankruptcy of an insolvent's causes of action.[42] In Australia, the scope of litigation funding has recently expanded with the emergence of funders who support general commercial litigation with no interest other than potential return on an investment.[43] Third parties usually agree to fund litigation in exchange for a fraction of any amount recovered in the litigation, plus any reimbursed costs ordered. Litigation funding is used in bankruptcy proceedings, breach of contract suits, and class action lawsuits.[44]

The change in Australia has been due partly to the gradual abolition of maintenance and champerty, which made it legal for funders to begin operations. Most Australian third-party funders in the 1980's and 1990's operated in the area of bankruptcy, historically an area in which the law was relatively clear about the legality of the third party funding.[45] Funders began operating to a limited extent in other areas in the late 1990s and 2000s, but did not expand rapidly because there was still substantial uncertainty about the legality of their ventures. It was not until the landmark Fostif decision in 2006 that the law regarding third-party funding was truly clarified.[46]

Fostif arose from a previous decision, Roxborough v. Rothmans of Pall Mall Ltd.,[47] concerning payments to tobacco retailers by tobacco wholesalers. The Fostif proceedings were initiated, organized, and funded by an outside company, Firmstone Pty Ltd.; on appeal, Australia's highest court took up the issue of the legality of the payment arrangement between ***1085** the parties.[48] Firmstone had signed agreements with over two thousand plaintiffs in connection with the damage recovery. The agreements included provisions that Firmstone would receive any litigation costs awarded to the plaintiffs plus one-third of the payments recovered from the wholesalers.[49] Firmstone would also pay all litigation and other associated costs and would arrange for counsel if litigation was necessary.[50]

The high court addressed the legality of Firmstone's arrangement with plaintiffs from two angles, asking (1) whether the actions of Firmstone constituted an abuse of process and (2) whether allowing it was counter to public policy. The court determined that the mere action of litigation funding by a third party was not an abuse of process.[51] It further found that, in jurisdictions where maintenance and champerty had been abolished, third-party litigation could not be counter to public policy.[52] By so holding, the Court solidified the footing of third-party funding in Australia.[53]

The Fostif decision occurred in the context of growing demand for litigation funding in Australia. In recent decades, the Australian population has increasingly looked to the legal system to determine social policy, as well as individual rights and duties.[54] In concert with the court's increased presence in daily interactions, Australians have also demanded greater access to the judicial system.[55] This general demand for access has been met by allowing third-party funders to both participate in, and, to a certain extent create, the market for legal claims.

Earlier court decisions had articulated a narrow range of situations in which claims assignment could be employed. For example, as early as 1908, courts permitted the transfer of claims in situations in which the ***1086** funder had a legitimate interest in the result of the lawsuit.[56] This legitimate interest requirement could be met where the parties were related by blood and in employer-employee relationships.[57] Likewise, an association established to protect the legal interests of its membership was also considered to have a legitimate interest.[58] The funders were also required to demonstrate that they neither planned to "on-sell" the claim nor "wager" on the outcome of the litigation.[59]

Funders that possess a "legitimate commercial interest[ ] in the outcome of a dispute also fall outside the prohibition against assignment of a bare cause of action."[60] Such an interest "might arise out of a charge over the assets and undertaking of the funded party's property," or[61] could exist where the funder claimed a right to "commission under disputed contracts."[62] Courts characterized some interests as mere hopes, and declined to permit a funder's intervention in situations in which the funder's commercial interest was contingent upon a favorable outcome in the litigation.[63] A "hope" of a commercial interest does not amount to a recognizable commercial interest.

In situations involving a bankrupt claim holder, the courts have permitted a broader definition of legitimate interest.[64] In bankruptcy, the bankrupt entity assigns its legal claims to the trustee, thereby allowing the trustee to pursue the matters in court.[65] The bankruptcy exception to the ***1087** prohibition against transfer of claims is justified for two reasons. First, liquidators, receivers, and trustees in bankruptcy owe fiduciary duties to the entity's creditors and debtors alike; thus, the interests of the parties are aligned despite the lack of a traditionally conceived "legitimate interest" in the disposition of claims.[66] They act as officers of the court and are obligated to perform their role, within the boundaries of the respective statutory provisions, to satisfy the interests of the creditors. Second, the trustee who fails to fulfill his or her duties to "close [the bankrupt entity's] estate . . . as expeditiously as is compatible with the best interests of parties in interest"[67] may risk loss of fees and/or prosecution, both civil and criminal.[68]

In general, Australian courts now appear to welcome litigation funding. According to QPSX Ltd v Ericcson Australia Pty Ltd., the exercise of due diligence and formulation of budgets by firms like IMF injects "a welcome element of commercial objectivity into the way in which such [complex commercial litigation] budgets are framed and the efficiency with which the litigation is conducted."[69]

II. What Litigation Funders Do

Litigation funding firms provide references, expertise, and most importantly, capital, to third parties pursuing legal claims.[70] In exchange, the funders receive a portion of the proceeds of any settlement or award at trial. While these firms could purchase the entire payoff from a claim, this would create a principal-agent problem. In most cases, the cooperation of the original claim holder is essential to successfully prosecuting a claim,[71] ***1088** and the best way to ensure this cooperation is by leaving the original claim holder holding a substantial portion of the claim to ensure the original claim holder's future cooperation. Thus, in practice, litigation funding firms tend to hold between thirty and sixty percent of the claim.[72]

At present, litigation funding firms tend not to be "interested in funding personal injury claims involving physical or mental injury to individuals that rely heavily on oral testimony and witness credibility because of the greater risks associated with these claims."[73] Instead, they "prefer commercial claims where the primary evidence is documentary.".[74] Firms also tend to set minimum values for claims; for example, one firm does not fund cases below seven hundred fifty thousand Australian dollars in value, while another firm wants a stake of at least one to two million Australian dollars.[75]

Firms fund cases where the risk is small and where they estimate the probability of winning a successful judgment or settlement to be large. At one firm, the probability of succeeding by judgment or settlement must be greater than ninety-five percent, while at another, the required probability of success is fifty percent. [76] Firms prefer cases that are likely to settle quickly, because the longer and more complex a matter is, the greater the firm's risk. [77] Litigation funding firms also thoroughly investigate the claim holder, especially if the claim holder is to be a key witness in the case. [78]

Claim owners must provide detailed information to the third-party funder prior to concluding the funding contract. The funder then uses the information to conduct a risk analysis. If the funder's exposure to risk is small, then the funder may make an offer of funding without further inquiry. However, if the risks are high, the funder does due diligence on the claim. [79] During this process, the funder will evaluate the claim amount, verify the liquidity of the defendant(s), obtain fee estimates for legal and other expert advice, and seek counsel's opinion regarding the likely success of the claim. Throughout this process, the funder retains the right to terminate the financing arrangement if new evidence emerges which ***1089** negatively impacts upon the chances of a successful outcome. [80]

Once funders become involved, their role within the litigation environment can vary. Some firms essentially act as a banker. Although they monitor the prosecution of the claim by the claim holder's lawyers and ensure compliance with budget caps, they do not participate in the day-to-day management of the claim nor do they provide instructions to the claim holder's lawyers. [81] While funders do engage in informal communication with the claim holders, they need not formally report to the client. [82] Although firms differ on this policy, some firms do not exercise veto rights over whether a claim holder accepts or declines a settlement offer. [83]

One firm requires the lawyers to report regularly, but it is not active in the control of strategy or in the management of litigation. The firm's main concern is that the claim is progressing within an agreed-upon budget. [84] It sets a global budget for legal services and the lawyers then determine how to "prosecute the claim within that budget;" however, it does not control the budget on a line-item basis. [85]

Other firms are even more active and monitor and advise throughout the process. [86] The funder may cap lawyers' fees and establish clear timelines to align budget and strategy. [87] Any settlement proposal must be a joint decision between the funding firm and the claim holder. In no case do the firms "have a fiduciary duty to the client," and instead see their "position as analogous to insurers," and only owe a "duty of good faith to the client." [88]

III. Theory

Economic theory is ambiguous as to the effects of litigation funding. While there have been several excellent theoretical discussions on the topic, [89] there has been little formal work and no empirical work conducted ***1090** to date. Below, we outline a simple model of litigation trading, but we first summarize some of the predictions from the theoretical literature.

Shukaitis (1987) suggests that litigation trading could increase the value of compensation to claimants and increase deterrence for a host of activities. [90] It could also lead to more nuisance suits and a greater volume and duration of litigation. [91] Litigation funding promotes claims brought by indigent and risk-averse victims that would not otherwise be pursued. [92]

Abramowicz (2005) maintains that litigation trading will lead to an increase in cases that are weak on the merits, but that plaintiffs manage to "puff up" by misrepresenting the particulars to a litigation funding company. Potential claims sellers will have an incentive to overstate their claims to potential buyers, thereby creating an adverse selection problem. [93] The third-party buyers have worse information about the claim than either the plaintiff or the defendant. Thus, only claims that do not settle are likely to be offered on the claims market. [94]

Abramowicz predicts litigation funding will cause an increase in cases being pursued in jurisdictions where damage awards are more unpredictable.[95] In such areas, risk-averse plaintiffs will prefer a small, sure recovery to a large, uncertain recovery. As a larger entity with deeper pockets, the litigation funder is able to act in a risk-neutral way. In one scenario Abramowicz posits, litigation funding companies will over-litigate (even at a loss) to create fearful reputations in the short-run, thereby facilitating easier settlements in the future.[96] Litigation funders will prefer a long-term strategy whereby most cases settle, because this would be the least costly method of maximizing profits.[97]

The qualitative literature predicts that under a litigation funding regime, claimants will recover the claim amount sooner and could minimize their own risk by selling to a risk-neutral third party. The third-party funders consolidate and accelerate cases because they can pool similar claims and act as repeat players.

Thus far, the literature discussed has considered ex post trading in litigation claims; that is, claims for which the harm has already occurred. ***1091** In a pair of fascinating papers, Robert Cooter considers a closely related topic: a market in unmatured claims.[98] Cooter proposes a market in which individuals could make ex ante sales of litigation claims, even before any harm occurs. For example, individuals with health insurance may want to sell the right to sue for a workplace injury, knowing that health expenses would almost certainly be covered by insurance.[99] While related to a market for third-party litigation funding ex post, Cooter's idea has yet to be implemented.

In Litigation Finance: A Market Solution to a Procedural Problem, Molot considers the shortcomings of the predominance of settlement in the current disposal of most litigation.[100] Parties to a settlement may have very different time or risk preferences, but settlements may differ substantially from those to which risk-neutral parties would agree. A market for litigation claims would allow risk-neutral parties to negotiate settlements (or litigate) with outcomes that better reflect the strength of cases and the law. Molot considers a related topic in A Market in Litigation Risk,[101] a paper that is closer to Cooter's (1988) and Cooter and Sugarman's (1989) work in considering the effects of trading ex ante litigation claims. In contrast, the focus of our paper is on trading or funding of ex post claims.

In order to be more precise about the expected effects of litigation trading on a market for litigation claims, we formally model the litigation process of a risk-averse claimant. Suppose a plaintiff bringing a suit has two possible outcomes, a gain of A or 0, with probabilities p and (1-p), respectively. The cost of bringing the suit is C. A risk-neutral individual pursues the suit if its expected value is greater than the cost; mathematically, this suit will be pursued if $pA > C$. If the individual is risk-averse, we can describe the individual as one who only pursues cases with a positive certainty equivalent. To be concrete, assume the following utility function over gambles:

$U = E(r) - 0.005R\sigma^2$, where R denotes the risk aversion parameter and the utility function is calibrated so that everything is measured in percent.[102] In terms of return, the gamble is between a gain of org] and a loss of 100%:

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***1092** The expected return is straightforward to calculate:

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We can also calculate how much uncertainty there is to the plaintiff, as measured by the variance of the return. Since there are only two possible outcomes, this simply requires calculating the variance for an uncertain event with binary outcomes, as follows:

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Which simplifies to:

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***1093** Now we return to the plaintiff's utility function and plug in for E(r) and

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and determine when this will have a positive value:

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Now this function can be examined or plotted to help understand the comparative statics. We can hold all other parameters fixed and take the derivative of p with respect to R or C. A decrease in R (the risk aversion parameter) will lead to a decrease in p. This illustrates that risk-neutral entities (like third-party funders) are willing to litigate cases with a lower probability of return.

The results for litigation costs, C, are a bit more complicated. For most reasonable values of C, higher litigation costs will lead to a requirement of a higher p: individuals litigate cases with a higher probability of success. This illustrates the theory that if litigation funding allows the smoothing of risk and the relaxing of credit constraints (and hence lowering of costs), individuals will litigate cases with a lower probability of a successful outcome and the number of suits may rise.

One limitation of this model, however, is that the probability p of winning a lawsuit is exogenous to litigation funding. But litigation funding could increase the probability of winning a lawsuit. For example, litigation funding may help in the discovery process. Larger, more complex lawsuits could arise and lawsuit quality could be endogenous to litigation funding. [103]

***1094** IV. Data

The empirics we present draw upon data from three main sources. First, we have personally been in contact with the largest litigation funding firm, IMF (Australia) Ltd, which has captured over half of the market share in Australia. [104] IMF has provided a list of lawsuits that it has funded as well as a list of lawsuits considered but not funded. The data from the lawsuits funded includes opening and closing dates, monthly profit and loss, expenditures, return on investment, case classification, and case location. [105]

Figure 1. Distribution of Case Duration of Cases Funded by IMF (Days)

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Between August 2001 and June 2010, IMF funded 113 cases, the average length of which was 850 days, or 2.33 years. [106] Figure 1 presents the case duration distribution, which is right-skewed. A handful of cases continued without resolution for many years, but the bulk of the cases are resolved within the first two years.

During this time period, IMF received an internal rate of return of seventy-five percent before overhead expenses. [107] Profits for most cases ***1095** ranged between a loss and gain of less than a million Australian dollars (AUD). As would be expected, losses are limited, and there are some notable cases with profits of several million AUD. [108]

Figure 2. Distribution of Profits Per Case

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Thirteen of the 113 cases actually went to court and were resolved by judicial opinion. From February 1999 to June 2007, IMF chose to fund 91 of the 763 cases considered. [109] The data available on cases considered includes the date opened, cause of action, management commentary, IMF investment manager, IMF state manager, estimated return, and the estimated completion

date.[110] From IMF's shareholder publications, we also obtained the jurisdictions of the cases that were funded from 2001 to 2003,[111] the case categories for all cases funded from 2004 to 2007,[112] and the total litigation contracts in progress from 2002 to 2008.[113]

Cases are classified primarily into three categories: commercial (often contract disputes), group (class action), and insolvency. The distribution across case type can be found in Table 1. Insolvency cases are the largest category, but this is largely attributable to the historic origins of litigation ***1096** funding.[114] Since bankruptcy was the one domain where purchasing litigation has historically been allowed, many of the earliest cases fall into this category. More recent cases represent a more diverse set of legal fields.

Table 1

Distribution of Funded Case Types

	Frequency	**Percent**
Commercial	21	23
Group	28	31
Insolvency	42	46
Total	91	100

Our second data source is the Australian Report of the Government (ROGS).[115] From this source we obtained data on the supreme and federal courts for each Australian state[116] separated by civil and criminal matters for the years 1994 to 2009.[117] The advantage of having criminal as well as civil data is that the criminal cases should not be affected at all by litigation funding. Thus, this data acts as a control group. The data includes lodgments, finalizations, several measures of expenditures and income, case backlog, case duration, clearance rate, court fees, and attendances (appearances) per finalization.[118] We also make use of population data for each state obtained from the Australian Bureau of Statistics, from which we create per capita lodgments and finalizations.[119]

1097** ***Figure 3. Map of Australian Jurisdictions[120]

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The third data source is LexisNexis Australia, from which we obtained data on all published opinions for cases considered by IMF between February 1999 and June 2007. Within the Lexis database, we searched for each of the 763 cases considered, locating a total of sixteen unfunded cases and seven funded cases.[121] For each of these cases we collected data regarding the date, attorneys, court, litigants, judge, citations to other cases, subsequent positive and negative citations, and more detailed information about the case.[122] This data was used to examine the effect of litigation funding on the establishment of precedent.

V. Analysis

The ideal experiment to test the theories described above would consist of a law change randomly chosen to take place in certain (treatment) jurisdictions and not in other (control) jurisdictions. One could then compare outcomes of interest such as settlement rates, settlement amounts, time to settlement, court caseload, court expenditures, and the ***1098** development of precedent, between the treated and control jurisdictions. Because of the recent changes in the attitudes toward litigation funding in Australia, we have a situation that comes close to the ideal experiment.

However, reality differs from the ideal in several important ways. First, while some Australian states have officially discarded maintenance and champerty doctrines, others have not; those that have not still allow litigation funding.[123] Second, the timing of the introduction of litigation funding in a state is not always coincident with the law change. Third, data on many of the most interesting outcome variables (particularly on settlements) is impossible to obtain.

With these limitations in mind, we proceed with an analysis that is as close to the ideal experiment as possible. As a proxy for the change in maintenance and champerty laws across jurisdictions, we use the amount of money IMF spent in a particular jurisdiction at a particular time. This becomes the key variable of interest in our regressions and serves as a measure of how open a particular state is to litigation funding. What we would like to do is determine the impact of the funding on various outcomes, while accounting for the fact that states have other differences besides funding levels and that funding can also vary over time for other reasons. In regression form:

Equation 1.

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where t indexes year and j indexes jurisdiction. Outcome_{jt} is one of the variables from the ROGS reports: lodgments, finalizations, several measures of expenditures and income, case backlog, case duration, clearance rate, court fees, and attendances (appearances) per finalization. δ_t and γ_j and are fixed effects for jurisdiction [124] and year, which allow for overall differences unrelated to funding levels in outcomes by state and year, respectively. [125]

In order to have a causal interpretation in the above regression, the variation of litigation funding across jurisdictions must be assumed to be ***1099** exogenous. It is possible that there are jurisdiction-year characteristics that attract funding and are also related to the outcomes of interest. To address this challenge to a causal interpretation, we make use of what is effectively a placebo: criminal cases. Because litigation funding is only allowed in civil cases, one would not expect any impact on criminal cases. These cases may thus be employed as a control for any unobservable overall changes in a jurisdiction at a particular time. We should then be able to draw a causal inference about the impact of more litigation funding on civil outcomes in a particular jurisdiction at a particular time. Thus, the dependent variable is the difference between the particular outcome measure for civil cases and for criminal cases.

Equation 2.

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Before proceeding to the main results, we first present in Figures 4-7 the variation in IMF funding over time in four Australian states. Although decreasing somewhat in 2008, New South Wales has seen relatively consistent funding levels of several million AUD per year between 2002 and 2007. The spending in Queensland is more volatile: spending was approximately one million AUD in 2002; it dropped off sharply through 2005, and since 2006 has recovered to some extent. Victoria has seen higher levels of funding than Queensland; however, its funding peaked in 2005 and has declined somewhat since then. Finally, Western Australia has seen a fairly steady growth in funding and was the only state examined to have an increase in funding in 2008. One of the important points to note from a comparison of the temporal funding patterns is that there is a substantial amount of variation across the states. This adds confidence to the assumption that funding is not driven simply by overall national time trends.

1100** ***Figure 4. IMF Annual Expenditures in New South Wales **[126]**

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Figure 5. IMF Annual Expenditures in Queensland **[127]**

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1101** ***Figure 6. IMF Annual Expenditures in Victoria **[128]**

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Figure 7. IMF Annual Expenditures in Western Australia [129]

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The main results of the regression analysis are presented in Panel A of Table 2, infra page 133. The table presents results from nine separate regressions, each using the specification described in Equation 2, supra page 127, with the dependent variable noted at the top of each column. The coefficient of interest is that on IMF expenditures and robust standard ***1102** errors are reported in parentheses.

Several interesting findings are apparent in the table. First, finalizations decrease with increased funding (column 2), although lodgments do not change a statistically significant amount (column 1). The combination of these observations suggests that cases tend to take longer to conclude when a litigation funder enters the legal market. There are several other pieces of evidence that point in the same direction. The backlog of non-appealed civil cases increases substantially relative to the non-appealed criminal backlog as IMF spending increases (column 6). As one might expect, it appears that finalizations decrease and the backlog increases. The clearance rate also declines to a statistically significant degree as third party funding increases (column 7). Finally, even when normalizing finalizations by population size, one sees a significant (at the ten percent level) decline with increased funding (column 8).

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***1103** Together, these regression results tell a consistent story: an increase in activity of litigation funders leads to more sclerotic courthouses. One might expect this increased litigation to be reflected in greater spending by the courts, and indeed columns 3 and 4 bear this out. While the coefficient on recurrent expenditures (column 3) is insignificant, the measure of expenditures that is more responsive to caseload fluctuations is net expenditures, which does have a statistically significant relationship with IMF expenditures. Overall, we see a pattern of increased funding corresponding to slower case processing, larger backlogs, and increased spending by the courts.

In the next section we discuss the robustness and significance of these findings and explore some possible channels for these results. For example, Panel B shows that IMF expenditures are not correlated with court processing outcomes in the year following the IMF expenditures.

First, we present the findings from the other main analysis undertaken, a comparison between funded and unfunded published cases (Table 3). From the universe of cases that IMF considered funding, we collect all with published opinions found in LexisNexis Australia. We compare the number of citations from and to other cases for the seven funded and sixteen unfunded published cases. There is a substantial difference in both measures of case significance. Funded cases cite almost forty other cases on average, while cases IMF chose not to fund cite fewer than twenty.

Even more indicative of case significance is the number of times funded cases have been cited. Here we find eleven citations on average for funded cases in comparison to fewer than five citations for the unfunded cases. The magnitude of the differences is extremely large. To the extent that citations are a good proxy for precedential importance, it appears that when litigation funders enter a market, they create more precedent earlier on. One potential concern may be that the funded cases are older, on average, than unfunded cases and have therefore had more time to gather cites. The funded cases are slightly older, less than 6 months on average, which is not enough to explain a disparity of this magnitude. We explore the robustness of the findings presented thus far in the next section.

Table 3. Citation Rates by Funded Status [130]

	Funded	**Not Funded**	**Ratio**
Citations to Other Cases	38.7 (32.1)	19.0 (22.7)	2.0
Citations to the Case	11.0 (8.9)	4.6 (7.8)	2.4
Observations	16	7	

***1104 VI. Robustness and Interpretation**

Since our identification strategy relies on changes in IMF expenditures across states and across time, the biggest concern to a causal interpretation is that IMF expenditures may themselves be driven by other factors that correlate with court processing. Moreover, the results presented so far do not rule out the possibility of reverse causality. Demand for third-party litigation funding may be greatest when the courts are the most backlogged. We address this concern in several ways. First, we look one year before the IMF expenditures to see if court processing is driving demand for third party litigation funding. Second, we use financial data on cases that IMF considered, both funded and non-funded, as a proxy for demand for third-party litigation funding.

One possible explanation for the results discussed thus far is that more congested courts attract more third-party funding. We test this by running the same regressions as presented in panel A of Table 2, but using IMF expenditure data from the year after the court processing data. We find (Panel C of Table 2) that no court processing measure is related to IMF expenditures in the year before the IMF expenditures occurred, except for attendances per finalization. This provides some support for IMF expenditures being unrelated to court processing.

Even though we use criminal cases as a control group to address ***1105** possible omitted variables, there are some omitted variables that may be specific to civil cases and litigation funding that could be correlated with court processing. For example, if IMF funding is representative of overall litigation funding and the other fifty percent of unmeasured litigation funding happens precisely where IMF funding occurs, then our estimates would be overestimated by a factor of two. On the other hand, if IMF is active precisely where the other fifty percent of litigation funders are not active, then our estimates would be understated, although in the extreme case, we would not be able to estimate any effects at all. This is likely not the case given the fact that some states still have champerty and maintenance facing criminal penalties on the books, even though it is not strictly enforced.

Alternative litigation funding is not the only source of omitted variable bias, however. Arbitration and contingency fee arrangements are also unmeasured. The same logic applies as in the case of alternative litigation funding. Here, it may very well be the case that these alternative funding arrangements compete, in which case our estimates are overestimates. Alternatively, if arbitration and contingency fees are used by the clients who were rejected by IMF or other litigation funders, then our tests using the measure for demand for litigation funding would alleviate this omitted variable concern.

Finally, we return to the issue of the development of law and establishment of precedent. Different courts may have different citation patterns and later cases may receive fewer citations than earlier ones. In Table 4, we improve upon the citation statistics reported in Table 3 by allowing for those possibilities. We find that funded cases still receive more total citations and that this is statistically significant at the ten percent level. If we included cases that did not go to court (or otherwise were not able to be found in Lexis Australia) as receiving no citations, then the estimated effects of funding are vastly more significant, as about eight percent of funded cases had an opinion but roughly two percent of non-funded cases had an opinion.

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

***1106** We additionally make use of data on the reversal rate of these cases. The funded cases are reversed twenty-five percent of the time. At first glance this suggests that litigation funding still has taint, as the courts do not appear to consider the law to have as precedential value for funded cases. In the respective jurisdictions and years, only five percent of cases are reversed. However, non-funded but considered cases are reversed thirty-one percent of the time. This suggests that the high reversal rate may actually be due to selection, and conditional on seeking IMF funding, funding actually decreases reversal rate.[131]

Conclusion

Ambitious statements have been made about the potential impact of allowing a market in litigation claims. Predictions include effects on settlement rates, settlement amounts, time before a settlement, litigation quantity, and development of precedent. In this paper we have sought to conduct the first empirical test of some of these claims using several newly-obtained datasets from Australia.

We find that litigation funders appear to have an impact on the functioning of courts. States that have a greater litigation funding presence experience a greater backlog in courts, fewer finalizations, and a lower clearance rate. This is also reflected in court expenditures, which increase with greater litigation funding.

While congesting the courts may be a cost of third-party funding, the ***1107** overall welfare effects could still be positive. If the value of the adjudication of cases is greater than the expense of adjudicating them, then third party funding should be encouraged. Further, court congestion may be a transitory effect of the entry of litigation funders, and not one that persists. The expectation would be that once defendants recognize the increased likelihood of litigation and the greater resources held by plaintiffs, they would be more likely to settle in equilibrium. While transitioning to that new equilibrium, there is another potential benefit from litigation funding: earlier resolution of the law.

Litigation funding does appear to have precedential value. By two different measures, cases funded by IMF have greater importance than those they did not fund, but which proceeded to trial in any case. Funded cases both cite and receive over twice as many references as unfunded cases. If citations are a good proxy for legal precedent, then third-party funding appears to promote its more rapid development. While a full welfare analysis is well beyond the scope of this paper, the closest real-world attempt at a market in litigation claims has had a meaningful impact on the judicial system in Australia.

***1108** Appendix: Data Definitions

Backlog Indicator - A measure of case processing timeliness. It is the number of pending cases older than the applicable reporting standards, divided by the total pending caseload (multiplied by one hundred to convert to a percentage).

Lodgments - The initiation or commencement of a matter before the court. The date of commencement is counted as the date of registration of a court matter.

Finalization - The completion of a matter so it ceases to be an item of work to be dealt with by the court. Finalizations are derived from timeliness data that may not reflect the total matters disposed by the courts in the reporting period.

Clearance Rate - A measure of whether a court is keeping up with its workload. It is the number of finalizations in the reporting period, divided by the number of lodgments in the same period (multiplied by one hundred to convert to a percentage).

Attendance Indicator - The average number of attendances for each finalization in the reporting period. An attendance is defined as the number of times that parties or their representatives are required to be present in court (including any appointment which is adjourned or rescheduled) for all finalized matters during the year. The actual attendance is one that is heard by a judicial officer or mediator/arbitrator.

Net Expenditure - Net expenditure refers to expenditure minus income (where income is derived from court fees and other revenue but excludes fines).

Recurrent Expenditure - Recurrent expenditure provides an estimate of annual service costs. Recurrent expenditure on courts administration includes judiciary and in-court expenditure, court and probate registries, sheriff and bailiff's offices, court accommodation and other overheads. The components of the expenditure include salary and non-salary expenditure, court administration agency and umbrella department expenditure, and contract expenditure. Total recurrent expenditure by Australian, State and Territory court authorities (excluding the High Court and specialist courts) was $1.2 billion in 2004-05.

***1109** Population - A lodgment that is yet to be finalized but is part of the case management of court administrators.

Footnotes

[a1] Associate Professor of Law, Cleveland-Marshall College of Law. This Article benefitted from the helpful comments of numerous colleagues. In particular, I would like to thank Joel Topcik and Miranda Hunt. I also appreciate the outstanding research assistance of William Doyle, Megan Lewallen and Angela Krupar, and the financial support of the Cleveland-Marshall Fund.

[1] See, e.g., Vicki Waye, Trading in Legal Claims: Law, Policy and Future Directions in Australia, UK and US 7 (2008) (discussing this argument).

[2] We use the terms “litigation trading,” “a market for litigation,” and “third-party funding” interchangeably. Each term refers to the ability of individuals or firms with no direct interest in a particular claim to buy a fraction of that claim.

[3] At a roundtable discussion session held at the conclusion of the 2010 UCLA-RAND Center for Law & Public Policy on Third-Party Litigation Funding and Claim Funding, it was noted that the stigma associated with this legal practice is managed in non-U.S. jurisdictions through “institutional acceptance, leadership by members of the judiciary, and law firms that champion[ ] third-party funding in the absence of contingency-fee arrangements.” Rand Institute For Civil Justice Program, Conference Proceedings, Third-Party Litigation Funding and Claim Transfer: Trends and Implications for the Civil Justice System 23 (2010) [hereinafter Rand Institute Conference Proceedings], available at http://www.rand.org/content/dam/rand/pubs/conf_proceedings/2010/RAND_ CF272.pdf.

[4] See Earl Johnson, Jr., Justice for America's Poor in the Year 2020: Some Possibilities Based on Experiences Here and Abroad, 58 DePaul L. Rev. 393 (2009) (discussing public funding of legal services in the United States).

[5] See generally J. P. Gould, The Economics of Legal Conflicts, 2 J. Legal Stud. 279, 281 (1973) (developing a framework for “analyzing the problem of trading among individuals in the face of uncertainty”); James W. Huges & Edward A. Snyder, Litigation and Settlement Under the English and American Rules: Theory and Evidence, 38 J.L. & Econ. 225 (1995) (examining behavior under two different legal fee regimes); William M. Landes, An Economic Analysis of the Courts, 14 J.L. & Econ. 61 (1971) (describing the economic theory for pre-trial settlement agreements); Richard A. Posner, An Economic Approach to Legal Procedure and Judicial Administration, 2 J. Legal Stud. 399 (1973) (explaining the procedural rules and practices that inform the legal-dispute resolution regime); George L. Priest & Benjamin Klein, The Selection of Disputes for Litigation, 13 J. Legal Stud. 1 (1983) (developing a model of the litigation process that identifies the characteristics of suits that settle and suits that are litigated).

[6] See Rand Institute Conference Proceedings, supra note 3, at 4 (noting that “[b]ecause the [litigation] process is so expensive, many with valid claims forgo litigation completely” and arguing that “[t]hird-party approaches to financing litigation ... may encourage more parties to pursue their claims” and thereby “reduce the problem of unfiled claims.”).

[7] See id. (arguing that litigation funding “could provide access to the courts for those who could otherwise not afford protracted litigation,” while cautioning that “[f]inancing may not flow to those litigants who cannot afford to litigate.”).

[8] See Rand Institute Conference Proceedings, supra note 3, app. B at 122 (“Parties choosing between a certain outcome and an uncertain outcome [in litigation] will be guided by their risk preferences”).

[9] See Jonathan T. Molot, Litigation Finance: A Market Solution to a Procedural Problem, 99 Geo. L.J. 65, 84 (2010) [hereinafter Molot, Litigation Finance] (discussing risk-aversion affects bargaining positions of litigants).

[10] See Waye, supra note 1, at 36 (citing Peter Charles Choharis, A Comprehensive Market Strategy for Tort Reform, 12 Yale J. on Reg. 435, 481 (1995)) (discussing Choharis' argument that extending the market for tort claims to allow investor involvement would increase access to justice, partially because it would overcome the collective action problem). Similar reasoning applies to the funding of class actions lawsuits. As some scholars have noted, however, the benefits of addressing the collective action problem must be weighed against the increased agency costs associated with adding layers between claims and the original claim holders. Janet Cooper Alexander, Do the Merits Matter? A Study of Settlements in Securities Class Actions, 43 Stan. L. Rev. 497, 534-48 (1991) (discussing conflicts of interest between attorneys and class action participants with regard to fee arrangements and settlement preferences); John C. Coffee, The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency in the Large Class Action, 54 U. Chi. L. Rev. 877, 887-88 (1987) (examining potentially detrimental effects of entrepreneurial litigation on those represented by class counsel); David Friedman, More Justice for Less Money, 39 J. Law & Econ. 211 (1996) (suggesting alternative method for allocating damages in asbestos class action case); Jonathan R. Macey & Geoffrey P. Miller, The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform, 58 U. Chi. L. Rev. 1, 12-27 (1991) (proposing auction in which attorneys bid opportunity to represent class, thereby restoring equilibrium between client and attorney interests).

[11] Certainly the system of law schools, bar certification, and ongoing professional education requirements seems to indicate that knowledge of the law is a specialized skill. Thus, the notion that an individual without this specialized knowledge is unaware that he possesses a legal claim is entirely plausible. See Louis Kaplow & Stephen Shavell, Legal Advice About Information to Present in Litigation: Its Effects and Social Desirability, 102 Harv. L. Rev. 565, 576 (1989) (noting that "individuals[ ] [have] generally imperfect knowledge of the law and the legal system," in the context of deciding whether to present evidence to a tribunal in the absence of legal advice); see also Waye, supra note 1, at 257 (discussing the motivation for third-party funders and attorneys operating under contingent-fee arrangements to "identify[ ] potential claim holders and market[ ] their services to them").

[12] 23 Samuel Williston & Richard A. Lord, A Treatise on the Law of Contracts § 62:4, 292-93 (4th ed. 2002 & Supp. 2011) (stating that one purpose of contingent fee contracts is to allow plaintiffs access to legal services); Vince Morabito, Federal Class Actions, Contingency Fees, and the Rules Governing Litigation Costs 21 Monash U. L. Rev. 231, 244 (1995) (stating that one of the benefits of contingency fees is that "they 'increase[e] access to justice by removing or reducing some of the costs [sic] disincentives that currently deter the initiation of legal proceedings'"); see also Molot, Litigation Finance, supra note 9, at 90 ("[C]ontingent fee arrangements transfer litigation risk from one-time plaintiffs, who are ill equipped to bear that risk, to attorneys who ... can more easily bear the risk"). Insurance markets are another alternative method for addressing the misalignment of incentives for pursuing positive-value claims. See, e.g., Tom Baker & Sean J. Griffith, Predicting Corporate Governance Risk: Evidence from the Directors' & Officers' Liability Insurance Market, 74 U. Chi. L. Rev. 487, 489 (2007) (discussing the transfer of corporate liability to insurance companies and noting that ownership of liability incentivizes insurance companies to "reintroduce[e] the deterrence function of corporate and securities law").

[13] See Molot, Litigation Finance, supra note 9, at 91 (noting that "only lawyers are permitted to take a share of the plaintiff's claim under a contingent fee arrangement"). For a discussion of contingency fees and attorney behavior, see Lester Brickman, The Market for Contingent Fee-Financed Tort Litigation: Is It Price Competitive?, 25 Cardozo L. Rev. 65 (2003).

[14] Seth Lesser, Partner, Klafter Olsen & Lesser LLP, Comments at RAND Litigation Finance Conference in Washington, D.C. (May 20, 2010) [hereinafter Seth Lesser Comments] (notes on file with authors).

[15] Waye, supra note 1, at 134.

[16] See supra notes 5-11 and accompanying text (explaining this assumption).

[17] See Molot, Litigation Finance, supra note 9, at 83-85 (discussing risk aversion, repeat litigants, and skewed settlements).

[18] Id.

[19] See supra notes 4-9 and accompanying text (noting that litigation funding allows more risk adverse parties to bring claims and for more complex claims to be brought).

[20] Our definitions of maintenance and champerty are derived from Shukaitis. Marc J. Shukaitis, A Market in Personal Injury Tort Claims, 16 J. Legal Stud. 329, 330 n.1 (1987); see also Rancman v. Interim Settlement Funding Corp., 789 N.E.2d 217, 219-20 (2003) (quoting Key v. Vattier, 1 Ohio 132, 143 (1823) in characterizing maintenance as “an offense against public justice,” which “perverts the remedial process of the law into an engine of oppression” and noting that “[t]he ancient practices of champerty and maintenance have been vilified”). For more information about the history of maintenance and champerty in Australia, see infra notes 29-39 and accompanying text.

[21] While settlement rates vary by location and nature of claim, settlement in civil trials has been estimated to be as high as ninety-five percent. See, e.g., Marc Galanter & Mia Cahill, ‘‘Most Cases Settle”: Judicial Promotion and Regulation of Settlements, 46 Stan. L. Rev. 1339, 1339-40 (1994) (citing frequently quoted figures that settlement rates are between eighty-five and ninety-five percent, but cautioning that these figures may be misleading); see also Cooper Alexander, supra note 10, at 498 (noting that “only a tiny fraction of litigated cases--perhaps five percent or less--are actually tried to judgment”).

[22] See Robert G. Bone, Modeling Frivolous Suits, 145 U. Pa. L. Rev. 519, 528 (1997) (explaining that “researchers cannot easily obtain settlement data because parties often keep settlements confidential, making it very difficult to test... the most serious effects of frivolous litigation”).

[23] The Australian firm IMF (www.imf.co.au) is not to be confused with the International Monetary Fund.

[24] See infra pt. 0.

[25] Of course, we cannot eliminate the selection effect completely, because even within the group of considered cases, there may be some unobservable characteristics that affected the ones that were picked for funding. But using the considered cases as the universe should at least mitigate the effect.

[26] See Eli Wald, Foreword: The Great Recession and the Legal Profession, 78 Fordham L. Rev. 2051 (2010) (discussing the recent downturn in the legal services market).

[27] See Milton C. Regan, Jr. & Palmer T. Heenan, Supply Chains and Porous Boundaries: The Disaggregation of Legal Services, 78 Fordham L. Rev. 2137, 2138-42 (2010) (describing the trend towards outsourcing legal services).

[28] See Marco de Morpurgo, A Comparative Legal & Economic Approach to Third-Party Litigation Funding, 19 Cardozo J. Int'l & Comp. L. 343, 345-46 (2011) (comparing various legal systems and third-party funding).

[29] Waye, supra note 1, at 12 (citing Jeremy Bentham, The Works of Jeremy Bentham 19 (John Bowring ed., 1843); Max Radin, Maintenance by Champtery, 24 Cal. L. Rev. 48, 57-62 (1935); and Percy H. Winfield, The History of Maintenance and Champerty, 35 L. Q. Rev. 50, 51 (1919)).

[30] Waye, supra note 1, at 12-13; see also Andrew Hananel & David Staubitz, The Ethics of Law Loans in the Post-Rancman Era, 17 Geo. J. Legal Ethics 795, 797 (2004) ("[t]he common law maintenance doctrine developed in feudal England in response to the practice of feudal lords of maintaining all of their retainers' lawsuits in order to enlarge their estates.").

[31] Waye, supra note 1, at 12.

[32] Waye, supra note 1, at 13-14.

[33] The United States still permits litigants to advance the theories of maintenance and champerty to challenge the validity of contracts, though those theories are rarely used in practice. See Jason Lyon, Revolution in Progress; Third-Party Funding of American Litigation, 58 UCLA L. Rev. 571, 584-87 (2010) (providing a brief history of American courts' attitudes towards third-party funding).

[34] Waye, supra note 1, at 14.

[35] Waye, supra note 1, at 14 (citing Criminal Law Act, 1967, c. 58, §§ 13, 14 (U.K.)).

[36] Waye, supra note 1, at 14 (citing Law Reform (Miscellaneous Provisions) Act 1955 (ACT) s 68 (Austl.) as amended by Civil Law (Wrongs) Act 2002 (ACT) s 221 (Austl.); Maintenance, Champerty and Barratry Abolition Act (No 88) 1993 (NSW) (Austl.); Criminal Law Consolidation Act 1935 (SA) sch 11 ss 1(3), 3(1) (Austl.); Crimes Act 1958 (Vic) s 322A (Austl.); Wrongs Act 1958 (Vic) s 32 (Austl.)). Even though criminal sanctions were abolished for maintenance and champerty, the common law ability to reject such contracts for public policy reasons remains. Overall, however, and in all districts, such contracts are usually enforceable. Waye, supra note 1, at 15.

[37] See Waye, supra note 1, at 14-15 ("Only a handful of cases have applied maintenance and champerty as torts in the United States in the last one hundred years."); Hananel & Staubitz, supra note 30, at 801-04 (comparing approaches to maintenance and champerty in United States jurisdictions); Susan Lorde Martin, Financing Litigation On-line: Usury and Other Obstacles, 1 DePaul Bus. & Com. L.J. 85, 87-89 (2002) (examining state approaches to champerty); Susan Lorde Martin, The Litigation Financing Industry: The Wild West of Finance Should Be Tamed not Outlawed, 10 Fordham J. Corp. & Fin. L. 55, 57-58 (2004) ("[I]n the United States, even in states that have maintained the prohibition against champerty in general, there have always been exceptions to the prohibition.").

[38] See Waye, supra note 1, at 14-15 ("[C]hamperty and maintenance continue to survive as rules of public policy ..."); Lyon, supra note 33, at 584 ("Champtery and maintenance still rear their heads in American courts. Though raised infrequently, they retain currency, at least in some jurisdictions."); Paul Bond, Comment, Making Champerty Work: An Invitation to State Action, 150 U. Pa. L. Rev. 1297, 1298 (2002) ("[C]hamperty's critics underestimate the continuing vitality of the doctrine.").

[39] England, like Australia, has also abolished maintenance and champerty as torts and offenses. Waye, supra note 1, at 14; see also George R. Barker, Third-Party Litigation Funding in Australia and Europe, 8 J.L. Econ. & Pol'y 451, 493-94 (2012) (discussing the abolition of maintenance and champerty as offenses in the U.K. and Australia).

[40] See Waye, supra note 1, at 57 (citing cases involving disposition by liquidators) (citing In re Park Gate Waggon Works Co. (1881) 17 Ch. 234 (Eng.) (disposition by liquidator); Re Movitor Pty Ltd (1996) 64 FCR 380 (Austl.) (disposition by liquidator); UTSA Pty Ltd v Ultra Tune Australia (1998) 146 FLR 209 (Austl.) (disposition by liquidator); Re Tosich Constr. Pty Ltd (1997) 73 FCR 219 (Austl.) (disposition by liquidator); Re William Felton & Co Pty Ltd (1998) 145 FLR 211 (Austl.) (disposition by liquidator)).(noting that this statutory exception only applies to property of the company. See Re Fresjac Pty Ltd (1995) 65 SASR 334 (Austl.)).

[41] See Waye, supra note 1, at 57 (citing cases involving disposition by a trustee) (citing Seear v Lawson (1880) 15 Ch D 729 (Eng.) (disposition by trustee); Guy v. Churchill (1888) 40 Ch D 481 (Eng.) (disposition by trustee); Re Nguyen, Ex parte Official Trustee in Bankruptcy (1992) 35 FCR 320 (disposition by trustee); Re Cirillo, Ex parte Offficial Trustee in Bankruptcy (1996) 65 FCR 576 (disposition by trustee)).

[42] See Interview with John Walker, Managing Director, IMF, (Australia) LTD (July 16, 2008) (interview notes on file with authors) (giving a brief overview of the history of maintence and champerty in Australia and third-party litigation funding). See also Hugh McLernon, In Support of Professional Litigation Funding 37-39 (IMF (Austl.) Ltd Litig. Funding Working Paper, 2005) (discussing the history of third-party litigation funding).

[43] Waye, supra note 1, at 58-63.

[44] See Waye, supra note 1, at 55; see also Laurie Glanfield, Litigation funding in Australia, Standing Committee of Attorneys-General Discussion Paper (2006) (describing the legal context of litigation funding).

[45] Interview with John Walker, supra note 42.

[46] Campbells Cash & Carry Pty Ltd. v. Fostif Pty Ltd. (2006) 229 CLR 386 (Austl.).

[47] Roxborough v. Rothmans of Pall Mall Ltd., (2001) 208 CLR 516 (Austl.).

[48] Fostif, (2006) 229 CLR 386.

[49] Id. at 477.

[50] Waye, supra note 1, at 236.

[51] Fostif, (2006) 229 CLR at 436.

[52] Id. at 432-435.

[53] See Waye, supra note 1, at 55 (noting that the Australian High Court effectively authorized litigation funding in its Fostif ruling, but cautioning that "Australian jurisprudence certainly stops well short of allowing full claim alienability and directly rejects the commodification of legal claims"); Michael Legg et al., Litigation Funding in Australia 2 (Univ. of N.S.W. Faculty of Law Research Series, Working Paper No. 12, 2010), available at http:// papers.ssrn.com/sol3/

papers.cfm?abstract_id=1579487 ("Since the High Court gave its ruling in Campbells Cash and Carry Pty Limited v Fostif Pty Ltd, the Australian litigation funding industry has enjoyed significant growth.").

54 See Waye, supra note 1, at 58 (citing Sir Anthony Mason, Law and Morality, 4 Griffith L. Rev. 147, 148-51 (1995) (commenting that the decline of religion, the extended family unit, and the disintegration of old social and economic conventions and standards have accentuated the importance of law in society and generated the expectation that the law will provide resolutions to pressing political and social problems)).

55 Waye, supra note 1, at 58.

56 Waye, supra note 1, at 58 (citing British Cash & Parcel Conveyors Ltd v Lamson Store Svc. Co Ltd [1908] 1 KB 1006 (Eng.)).

57 Id. (employing the legitimate interest requirement)).

58 See Waye, supra note 1, at 58 (citing Martell v Consett Iron Co Ltd [[1955] Ch 363 (Eng.) (unincorporated association); Magic Menu Sys. Pty Ltd v AFA Facilitation Pty Ltd (1996) 72 FCR 261 (Austl.) (franchise); Moloney v Housing Indus. Ass'n Ltd (Unreported, Tas SC Dec. 4, 1992) (Austl.) (trade association)).

59 See Waye, supra note 1, at 58 (citing S. Australian Asset Mgmt. Corp. v Sheahan (1995) 13 ACLC 328 (Austl.); JC Scott Constrs. Pty Ltd v Mermaid Waters Tavern Pty Ltd [1982] 2 Qd.R. 413 (Austl.); Re Movitor Pty Ltd (1996) 64 FCR 380 (Austl.); Trendtex Trading Corp. v. Credit Suisse [[1982] A.C. 679 (Eng.); Giles v. Thompson [1994] 1 A.C. 142, 146 (U.K.)).

60 Waye, supra note 1, at 58.

61 See Waye, supra note 1, at 58 (citing Vangale Pty Ltd v Kumagai Gumi Co Ltd [2002] QSC 137 (Austl.)).

62 Id.

63 See Waye, supra note 1, at 58-59 (citing Project 28 Pty Ltd (formerly Narui Gold Coast Pty Ltd) v Barr, [2005] NSWCA 240 (Austl.)).

64 See Waye, supra note 1, at 59 (citing Stevens v Keogh (1946) 72 CLR 1, 2 (Austl.) (holding that funding by the Police Association of New South Wales of an action brought by an insolvent member was not maintenance)).

65 In re Tomaiolo, 205 B.R. 10 (Bankr. D. Mass. 1997) (legal malpractice claims were property of estate and trustee therefore had right to pursue those claims);. But see Christison v. Jones, 405 N.E.2d 8 (Bankr. Ill. App. 3d 1980) (holding that a legal malpractice claim is not part of the bankrupt's estate because it is not subject to assignment).

66 See In re WHET, Inc., 750 F.2d 149 (1st Cir. 1984) (a trustee in bankruptcy "owes a fiduciary duty to debtor and creditors alike to act fairly and protect their interests"); In re Rigden, 795 F.2d 727, 729 (9th Cir. 1986) ("The trustee ... has a fiduciary obligation to conserve the assets of the estate and to maximize distribution to creditors."); In re Heinsohn, 247 B.R. 237, 244 (E.D. Tenn. 2000) ("A bankruptcy trustee is a fiduciary of the estate, its beneficiaries and the creditors.").

[67] 11 U.S.C. § 704(a) (2006).

[68] See, e.g., In re Hutchinson, 5 F.3d 750 (Bankr. 4th Cir. 1993) (discussing the source of trustee liabilities as Mosser v. Darrow, 341 U.S. 267 (1951)); In re NWFX, Inc., 384 B.R. 214 (Bankr. W.D. Ark. 2008) (ordering disgorgement of trustee's fees after it was discovered that trustee made certain misrepresentations regarding the proposed settlement).

[69] QPSX Ltd v Ericsson Australia Pty Ltd (2005) 219 ALR 1 (Austl.).

[70] See Waye, supra note 1, at 41-45 (describing the relationship between litigation funding firms and claim holders).

[71] See Shukaitis, supra note 20, at 340-41 (discussing how to incentivize the original claim holder to participate in litigation); George Steven Swan, Economics and the Litigation Funding Industry: How Much Justice Can you Afford?, 35 New Eng. L Rev. 805, 819-20 (2001) (noting that successful recovery in a suit may depend on the cooperation of the tort victim).

[72] Interview with John Walker, supra note 42; see also Legg, supra note 54 (providing examples of funding agreement provisions in which the funding firm receives only a portion of a judgment or settlement recovery).

[73] Waye, supra note 1, at 282-83.

[74] Interview with John Walker, supra note 42.

[75] Waye, supra note 1, at 282-83.

[76] Id.

[77] Id.

[78] Id.

[79] Id. at 41.

[80] Id. at 41.

[81] Id. at 286-87.

[82] Id. at 287-88.

[83] Id. at 284-85.

[84] Id. at 286.

[85] Id.

[86] Id. at 286-87.

[87] Id.

[88] Id. at 284-86.

[89] See, e.g., Michael Abramowicz, On the Alienability of Legal Claims, 114 Yale L.J. 697 (2005) (considering the normative question of whether legal claims should be alienable); Robert Cooter, Towards a Market in Unmatured Tort Claims, 75 Va. L. Rev. 383 (1989) [hereinafter Cooter, Towards a Market] (developing a model for unmatured tort claims in light of economic theory); Mariel Rodak, It's About Time: A Systems Thinking Analysis of the Litigation Finance Industry and Its Effect on Settlement, 155 U. Penn. L. Rev. 503 (2006) (applying systems thinking to litigation finance).

[90] Shukaitis, supra note 20, at 334-41.

[91] Id. at 342-46.

[92] See id. at 338 ("Given their expected risk averseness, poorer tort victims may be especially dissuaded from pursuing valid claims because of the costs involved.").

[93] Abramowicz, supra note 89, at 743-45.

[94] Id. at 744-45; Shukaitis, supra note 20, at 344.

[95] Abramowicz, supra note 89, at 735-37, 740-41.

[96] Id. at 728.

[97] See id. at 728-29 (analogizing litigation funders to insurance companies, which often settle cases)..

[98] Robert Cooter & Stephen D. Sugarman, A Regulated Market in Unmatured Tort Claims: Tort Reform by Contract, in New Directions in Liability Law 174 (W. Olsen ed., 1988); Cooter, Towards a Market, supra note 89.

[99] In a later paper, Cooter labels such a system "anti-insurance." Robert Cooter & Ariel Porat, Anti-Insurance, 31 J. Legal Stud. 203 (2002).

[100] Molot, Litigation Finance, supra note 9.

[101] Jonathan T. Molot, A Market in Litigation Risk, 76 U. Chi. L. Rev. 367 (2009).

102 This type of utility function is sometimes used in finance for illustrative purposes. While it is clearly unrealistic for some values, it is chosen here because of its analytical tractability.

103 On the other hand, litigation funding could decrease the amount of damages awarded if the court knows that the damages awarded are going to a third party.

104 Letter from John Walker, Exec. Director, IMF (Australia) Ltd, to Laurie Glanfield, Secretary, Standing Committee of Attorneys-General, (Aug. 11, 2006) (on file with the University of Pennsylvania Journal of Business Law).

105 David S. Abrams & Daniel L. Chen, IMF Lawsuit Financial Data (Sept. 8, 2010) (unpublished spreadsheets) (on file with the author) [hereinafter Abrams & Chen, IMF Data]. These documents are confidential and cannot be distributed publicly.

106 Id.

107 Id.

108 Id.

109 Abrams & Chen, IMF Data, supra note 105.

110 Id.

111 Alden Halse & Hugh McLernon, IMF (Australia) Ltd, IMF (Australia) Ltd August 2003 Presentation (Aug. 2003) (on file at the University of Pennsylvania Journal of Business Law).

112 IMF (Australia) Ltd, 2008 Annual Report (June 30, 2008), available at http://www.imf.com.au/annualreports.asp.

113 Id. at 53.

114 John Walker, IMF (Australia) LTD, Submissions on State Regulation of Litigation Funding 4 (2005); Waye, supra note 1, at 5.

115 Australian Gov't Productivity Comm'n, Report on Government Services, http://www.pc.gov.au/gsp/reports/rogs (last visited Jan. 30, 2011). Not all variables were available for all years.

116 See Figure 3, infra, for a map of Australia.

117 Report on Government Services, supra note 114.

118 For a definition of these variables, please see the Appendix.

[119] Australia Bureau of Statistics, Australian Demographic Statistics, http://www.abs.gov.au/AUSSTATS/abs@.nsf/second+level+view? ReadForm&prodno=3101.0&viewtitle=Australian%20Demographic %C20Statistics~Jun% 202010~Latest~21/12/2010&&tabname=Past%20Future %C20Issues&prodno=3101.0&issue=Jun%2010&num=&view=& (last visited Jan. 30, 2011).

[120] Australia States Rs01- Australia Maps, Mapsof.net, http:// mapsof.net/map/australia-states-rs01#.UWRWCBlXxcJ (last visited Apr. 9, 2013).

[121] The LexisNexis searches were based on the description that IMF recorded for each case considered.

[122] David S. Abrams & Daniel L. Chen, LexisNexis Australia Compilation of Opinions from IMF Considered & Funded Cases (2010) (unpublished document) (on file with the author) [hereinafter Abrams & Chen, LexisNexis Australia Data].

[123] Waye, supra note 1, at 55-78. Mere funding is not maintenance and mere funding for reward is not champerty. Impropriety needs to be proved. Litigation funding firms can fund in the States and Territories that have not abolished maintenance and champerty, and if challenged, these firms merely need to prove that their funding is not improper maintenance. See supra Part 0 (citing examples where courts have found that litigation funding was not improper maintenance).

[124] Because we use state fixed effects, a jurisdiction that has no IMF expenditures during our timeframe will drop out in our analysis.

[125] We use robust standard errors and do not cluster our standard errors at the state level since our dataset would only have seven clusters--too few by conventional standards.

[126] Abrams & Chen, IMF Data, supra note 105.

[127] Abrams & Chen, IMF Data, supra note 105.

[128] Abrams & Chen, IMF Data, supra note 105.

[129] Abrams & Chen, IMF Data, supra note 105.

[130] The figures in parentheses represent standard deviations. Abrams & Chen, LexisNexis Australia Data, supra note 122.

[131] This analysis does not address the conventional view of taint, where a jury finds out that the damages being awarded to a party are actually going to a litigation funder. None of the cases where we found opinions in Lexis Australia had juries.

15 UPAJBL 1075

Citations:

Bluebook 21st ed.
Michelle Boardman, Insurers Defend and Third Parties Fund: A Comparison of Litigation Participation, 8 J.L. ECON. & POL'y 673 (2012).

ALWD 7th ed.
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INSURERS DEFEND AND THIRD PARTIES FUND: A COMPARISON OF LITIGATION PARTICIPATION

*Michelle Boardman**

Insurance companies provide a legal defense for their liability policyholders who have been sued. This defense commonly takes the form of the insurer selecting, paying, and directing the lawyer. This lawyer has two co-clients—the insurer and the policyholder–defendant.[1] While this arrangement has downsides, its value is well known and accepted.

Proponents of expanding third-party litigation funding in the United States argue that the insurer defense model supports and even necessitates expansion. A comparison between these relationships is strained; the occasional similarity is overwhelmed by the differences. This article is the first to fully consider the value of the comparison between the two forms of litigation funding. It concludes that the insurer defense model can provide some insight but that several of the more causal, common analogies between the two funding forms should be put aside. It does not take a stance on the larger question of whether or how third-party litigation funding should be expanded in the United States.

Why compare third-party litigation funding with insurer litigation defense? Before evaluating the more specific claims that are being made about the two, there are several general reasons to explore insurer defense funding. First, an insurer's defense of its policyholder can be considered a form of third-party litigation funding, one that is already prevalent in the United States.[2] We might hope to see the future of the new funding forms by looking at the present insurer defense model. Second, insurance compa-

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* Assistant Professor of Law, George Mason University School of Law. Thank you to Henry Butler and the Searle Civil Justice Institute at George Mason's Law & Economics Center, participants at the New York conference on "Third-Party Financing of Litigation: Civil Justice Friend or Foe?," and participants at the Brussels "Global Conference on Third-Party Financing of Litigation," particularly Joanna Shepherd Bailey, George Barker, Jeremy Kidd, Alan Morrison, and Anthony Sebok.

[1] *See infra* Part II.D. for a discussion of this co-client relationship. In the rare cases where a conflict between the insurer and policyholder makes this relationship impossible, the insurer withdraws from all but the obligation to pay for the policyholder's defense of a claim.

[2] *See, e.g.*, GEOFFREY MCGOVERN ET AL., RAND INSTITUTE FOR CIVIL JUSTICE PROGRAM, CONFERENCE PROCEEDINGS, THIRD-PARTY LITIGATION FUNDING AND CLAIM TRANSFER: TRENDS AND IMPLICATIONS FOR THE CIVIL JUSTICE SYSTEM 2 n.2 (2010), *available at* http://www.rand.org/pubs/conf_proceedings/CF272 [hereinafter RAND CONFERENCE 2009]. In the United States insurers typically pay on the claims of their policyholders and then sue to recover damages from the third parties that caused the damage covered under the insurers' policies, a procedure called "subrogation." *Id.* at 8. "Before-the-event and after-the-event legal insurance policies are not common in the United States . . . ." *Id.*

nies play a larger role in European litigation financing.[3] Litigation expense insurance is not yet an American phenomenon, however. Third, the large litigation investor funds like Juridica "partner[] and co-invest[] with other leading financial institutions and *insurers* in London and New York."[4]

In addition to the more general argument that insurers already are litigation funders, this article will flesh out and examine two additional specific claims. First, there is the possible unfairness "of the defendant's ability to transfer risk to an insurance company before the event, while plaintiffs are left to absorb all the risk of returns on their claims until the eventual outcome."[5] The lack of parity between the plaintiff's and defendant's positions also has consequences beyond fairness concerns. The next claim assumes the greater including the lesser: If an insurer's *control* of a defendant's litigation is palatable, then mere investor *involvement* must be even more so. In other words, insurers interject themselves into settlement decisions in defense actions; litigation funding will be less intrusive and thus we need not worry about interfering with either the lawyer's or the client's legal judgment. To evaluate both of these claims, we will continue to return to the first general claim that insurers are litigation funders in the same relevant sense as that term is used to apply to third-party litigation funders.[6]

For purposes of this article, third-party litigation funding will (a) often be shortened to "litigation funding" and (b) refer to investments in commercial plaintiffs' suits by funds and, at times, nonrecourse loans made to individual plaintiffs in tort suits. This paper does not fully address other forms of litigation funding such as lawyer–client contingency fee arrangements or outright claim transfer in which a legal claim is sold to and pursued by a party outside the original dispute. This division serves several functions. First, it is in keeping with "third-party litigation funding" becoming a term of art, not a bare description. Second, the analogies that are drawn from insurer defense funding are focused on analyzing this subset of

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[3] *See* Anthony Heyes, Neil Rickman, & Dionisia Tzavara, *Legal Expenses Insurance, Risk Aversion and Litigation*, 24 INT'L REV. L. & ECON. 107, 108 (2004). However, as other articles cited in this volume explore, the role of insurers in European litigation funding seems to have been overstated.

[4] JURIDICA CAPITAL MGMT. LTD., http://www.juridica.co.uk/about.php (last visited Mar. 1, 2012) (emphasis added).

[5] RAND CONFERENCE 2009, *supra* note 2, at 52 (Appendix B: Presenter Materials, from Keynote Speech by Lord Daniel Brennan).

[6] There is another claim that merits discussion but falls outside the scope of this piece. Lord Daniel Brennan, Chairman of Juridica Capital Management, asks, "Why should an insurance company be able to take direct control of a claim through the contract right of subrogation, while a financial institution is restricted from purchasing an interest in a legitimate legal claim held by a business?" *Id.* This claim addresses the fitness of certain institutions to pursue claim transfer, which is not third-party litigation funding. Litigation funding and claim transfer may be substitutes in certain circumstances; for example, both allow for a market in litigation investment. Nonetheless, the legal and ethical restrictions on claim transfer are a substantial topic unto itself. The dynamics and incentives of insurer plaintiff subrogation suits likewise merit a comprehensive, separate discussion.

litigation funding. A comparison between insurer defense and contingency fees might well prove interesting another day. Third, sloppy thinking can result, and has resulted, from simultaneously using the phrase "litigation funding" in both the narrow and the broader sense in one breath.

Part I describes the type of third-party litigation funding at issue in this article. Part II sets forth the nature of the relationship between defendant policyholders and their third-party liability insurer. This part begins the comparison between litigation funding and insurer defense. Readers with a working knowledge of litigation funding and liability insurance may want to skim these sections but should not skip them. Part III delves into the three comparison claims described above.

I. THIRD-PARTY LITIGATION FUNDERS

In this article, "third-party litigation funding" refers to either investment in commercial plaintiffs' suits by litigation investment funds or non-recourse loans made to individual plaintiffs in tort suits, known as lawsuit lending.[7] These forms of litigation funding involve a potential plaintiff and a party who is not otherwise related to the litigation. The borrower-plaintiff may already be engaged in litigation, but it is more likely that the borrower is a person or entity holding a legal claim. The third-party funder agrees to pay all or part of the plaintiff's legal costs in exchange for payment, usually a percentage of the plaintiff's recovery.[8]

The purpose of litigation funding depends upon the plaintiff. For commercial plaintiffs, we can generally assume that the purpose is to transfer some or all of the litigation risk to a third party. A business can increase the expected value of a suit by shifting the litigation risk to a party who values the expected reward more than the expected risk.[9] For individual tort plaintiffs, we may generally assume the purpose is to make the litigation possible because the plaintiff does not otherwise have the resources to sustain the case even though the plaintiff's lawyer is operating on contingency. Perhaps because contingency fee arrangements are permissible in

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[7] This article does not address the rare cases in which a *defendant* receives third-party funding from sources other than its insurer.

[8] *See infra* Part II.B. for a discussion of the various stakes that parties providing litigation support may have in the outcome of the litigation.

[9] On the defense side, Jonathan Molot has set forth a three-tiered structure of litigation risks based upon Guido Calabresi's primary, secondary, and tertiary costs of accidents. *See* Jonathan T. Molot, *A Market in Litigation Risk*, 76 U. CHI. L. REV. 367, 372-75 (2009) (citing GUIDO CALABRESI, THE COSTS OF ACCIDENTS (1970)). Molot's goal is "to develop a risk-transfer and risk-pooling mechanism that could reduce the secondary and tertiary costs of litigation. . . . [T]he hypothetical defendant . . . would not have to retain litigation risk for the duration of a lawsuit. Instead, it could choose to pay the 'expected value' of its lawsuit plus a premium to protect against a higher-than-expected loss." *Id.* at 375.

the United States, unlike in many other countries, the loans available to individual plaintiffs seem to be limited to living while litigating and not to lawyers' fees directly.[10] Of course, in either the individual or the commercial case, litigation funding may make the difference between a suit being brought or not brought; a commercial entity can have the resources to bring a suit but believe the suit is not worth the litigation risk.

The two primary investor funds in the United States are Juridica Capital Management (US) Inc., launched in 2007,[11] and Burford Capital Limited, launched in 2009.[12] Because the funds are relatively new and their operations are not fully public, there is some uncertainty about how the fund model will develop. Juridica describes itself as "a lawyer-owned financial services company operated in an investment banking tradition and focused exclusively on capital and finance for corporations, law firms, lawyers, and claim-holders worldwide."[13] It also touts its legal and case expertise, suggesting at least the possibility of its deeper involvement in case decisions after the initial investment decision.[14] It arranges various forms of funding for both law firms and claim owners but "does not arrange finance for personal injury claims or for mass tort claims, except in special circumstances."[15] Juridica exclusively manages worldwide operations of Juridica Investments Limited, which is listed on the Alternative Investment Market of the London Stock Exchange.[16]

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[10] Whether plaintiffs unable to secure a contingency fee arrangement could interest a third-party litigation funder to invest in their litigation is a question that merits further investigation. *See* Marco de Morpurgo, *A Comparative Legal and Economic Approach to Third-Party Litigation Funding*, 19 CARDOZO J. INT'L & COMP. L. 343, 356 (2011).

[11] *History*, JURIDICA CAPITAL MGMT. LTD., http://www.juridica.co.uk/history.php (last visited Apr. 13, 2012).

[12] *Investor FAQs*, BURFORD, http://www.burfordfinance.com/en/investor-relations/investor-faqs (last visited Apr. 13, 2012).

[13] JURIDICA CAPITAL MGMT. LTD., http://www.juridica.co.uk/about.php (last visited Mar. 1, 2012).

[14] *Id.* ("Through over fifty years' combined experience in finance and law product innovations, Juridica's principals have developed an extensive, world-wide network of leading law, legal ethics, finance and consulting experts and scholars. Juridica calls on this network to assist in case and risk analysis, financial modeling and financial product design."). Lord Brennan, Chairman of Juridica Investments Limited, states that Juridica "employs: a cutting edge underwriting system; effective due diligence; full financial analysis of all factors affecting the investment, legal, financial, and overall return on the investment; quality experts on ethics, liability, damages, and enforceability; [and] the best lawyers." RAND CONFERENCE 2009, *supra* note 2, at 55 (Appendix B: Presenter Materials, from Keynote Speech by Lord Daniel Brennan).

[15] *Claim Sectors*, JURIDICA CAPITAL MGMT. LTD., http://www.juridica.co.uk/claim.php (last visited Mar. 1, 2012).

[16] *Juridica Investments Limited*, JURIDICA CAPITAL MGMT. LTD., http://www.juridica.co.uk/investments.php (last visited Mar. 1, 2012).

The largest investor fund, "Burford Capital Limited[,] is a publicly listed fund that invests in commercial disputes."[17] Burford considers United States commercial disputes and international arbitration to be its "core business" areas.[18] Like Juridica, many of Burford's principals are lawyers. After all, legal expertise is central to choosing in which cases to invest and how deeply. "Juridica prefers to examine potential business-related claim investments that have been vetted and accepted by qualified lawyers."[19] The open question is whether the lawyers remain involved with the borrower's case after making the initial loan. Burford Capital describes itself as a dispute financier; Burford Group, which describes itself as the investment advisor to Burford Capital, has stated in the past that its goal is "not only to arrange critical funding, but *to improve the odds of a favorable outcome*."[20]

A litigation investment fund that has lent a set amount has every incentive to encourage a favorable outcome; payment may be contingent upon a positive settlement or award and it may be in the form of a percentage of the plaintiff's recovery. A fund that has pledged to lend a variable amount, depending on litigation costs, may reach a point where it prefers to cut its losses and accept a "losing" settlement over investing additional resources in the litigation or settlement negotiations. In both cases the fund mirrors an indemnity insurer, who has an incentive to minimize (maximize) the amount paid out (paid in) under the policy in settlement or award. As discussed elsewhere, their incentives as to litigation *costs* may differ. An insurer is more like a contingency fee lawyer in the sense that it must decide how much to spend on the litigation as the case unfolds. An insurer is dissimilar from both a litigation investment fund and a contingency fee lawyer in that the insurer's funds are on the hook for the eventual settlement or court award.

Much of the analysis of litigation funding in the United States has assumed a model in which the funds do not attempt to influence the borrower's litigation or settlement decisions after the initial investment has

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[17] Press Release, Burford Capital, Burford Capital Limited Interim Results 2011 (2011), *available at* http://www.burfordfinance.com/docs/default-document-library/burford_capital_interim_2011_web.pdf [hereinafter Burford Interim Results 2011; *see also* BURFORD, http://www.burfordfinance.com/home (last visited Mar. 1, 2012).

[18] Burford Interim Results 2011, *supra* note 17, at 2. Other funds, most of which do not have an American presence, include Allianz, Credit Suisse, Claims Funding International PLC, Context Capital, Harbour Litigation Funding, and IM Litigation Funding. RAND CONFERENCE 2009, *supra* note 2, at 69-71.

[19] *How We Work*, JURIDICA CAPITAL MGMT. LTD., http://www.juridica.co.uk/how.php (last visited Mar. 1, 2012).

[20] *See* BURFORD, http://www.burfordfinance.com/en (last visited Mar. 1, 2012); *see also* Roger Parloff, *Have You Got a Piece of This Suit?*, CNN MONEY (June 28, 2011, 2:06 PM), http://features.blogs.fortune.cnn.com/2011/06/28/have-you-got-a-piece-of-this-lawsuit-2/ ("Our goal is . . . to improve the odds of a favorable outcome." (quoting Burford's website)).

been made. Whether advice or pressure is brought to bear during litigation, a fund could influence the litigation's path by requiring an agreement about approach and settlement stance before making the investment commitment. For purposes of this article, which does not turn on the question, it is reasonable to consider it possible, but not proven, that litigation investment funds would influence strategy before or during litigation.

On the individual tort-plaintiff side, the borrowing structure is a fairly simple non-recourse loan. If the would-be plaintiff's lawyer is the one making the loan, we call it a contingency fee. If an outside lender makes the loan, it is third-party litigation funding.[21] The "leading provider of litigation financing, plaintiff funding, and lawyer funding," at least according to itself, is LawCash, whose website describes its business model in detail.[22] If a plaintiff already engaged in a contingency fee suit borrows money for non-litigation expenses during the suit, there does not seem to be a set name—"third-party litigation support funding" is too long and "lawsuit living lending" is too alliterative. A separate term is called for, although the term "lawsuit lending" is used to apply to the entire tort plaintiff field.

Lawsuit lenders have faced difficulty in some states. Courts have held the contracts void, calling the lenders "intermeddlers" who should not be "permitted to gorge upon the fruits of litigation."[23] In the case of this language from the Supreme Court of Ohio, the state legislature made the contracts legitimate again five years later.[24] The American Tort Reform Association (ATRA) has urged state legislatures and the American Bar Association to resist approving or legitimizing this form of litigation funding. ATRA argues that lawsuit lending "generally targets low-income Americans with a convenient if usurious line of credit" and "fundamentally shifts the focus of courts from promoting and administering justice to serving as a forum for investors to wager on lawsuits."[25]

On the other side, the American Legal Finance Association (ALFA) is a trade association that represents some twenty third-party litigation support funders whose clients are individual plaintiffs in personal injury suits. The association sets forth industry "best practices" and coordinates with state

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[21] *See infra* Chart 1 for a comparison of the two.

[22] LAWCASH, http://www.lawcash.net (last visited Mar. 2, 2012). LawCash does appear to be one of the largest lawsuit lenders.

[23] Ben Hallman & Caitlin Ginley, *States are Battleground in Drive to Regulate Lawsuit Funding*, IWATCH NEWS (Feb. 2, 2011, 2:50 PM), http://www.iwatchnews.org/2011/02/02/2160/states-are-battleground-drive-regulate-lawsuit-funding (quoting the Ohio Supreme Court in 2003).

[24] *Id.*

[25] Press Release, Am. Tort Reform Ass'n., ATRA Urges ABA to Resist Third-Party Lawsuit Lending (Feb. 16, 2011), *available at* http://www.atra.org/newsroom/atra-urges-aba-resist-third-party-lawsuit-lending. *See also* Am. Bar Ass'n., *Comments: Issues Paper Concerning Lawyer's Involvement in Alternative Litigation Financing* (Alt. Litig. Fin. Working Group Issues Paper, 2011), *available at* http://www.americanbar.org/content/dam/aba/migrated/2011_build/ethics_2020/comments_on_alternative_litigation_financing_issues_paper.authcheckdam.pdf.

governments on voluntary agreements, regulations, and legislation.[26] According to ALFA, its members provide non-recourse loans to individuals who already have an arrangement with a contingency fee lawyer. The ALFA member funds not the litigation but rather the non-litigation costs of living while awaiting an award of damages.[27] These costs include medical bills resulting from the injury and house payments or other payments that have become difficult because the plaintiff is out of work.[28]

Obviously, money is fungible. Does it make sense to think of ALFA members as funding living while litigating and not funding the litigation itself? Yes, it does, given that the loans for each are nonrecourse. The plaintiff does not give the contingency fee lawyer any money up front. He is not using the money from the ALFA lender to repay his lawyer during or after the suit. If the suit comes to nothing, he owes neither his lawyer nor the lender.

On the other hand, the existence of the ALFA lender will in some cases allow a plaintiff to bring or maintain suit where before he would have abandoned suit or settled earlier. A tort plaintiff with little personal means, whose job is disrupted by injury and whose medical bills are due, will settle for less in order to get payment sooner than a plaintiff who can afford to wait while his bills are paid by a nonrecourse loan. The contingency fee lawyer may direct his clients to lawsuit lenders for this reason; the lawyer sees a winning case but knows it will take more time than the plaintiff has to recover the reward.

II. THE INSURANCE DEFENSE PICTURE

The existing generalizations about the similarities between litigation funding and insurance defense have assumed knowledge of the insurance side. The lack of explicit comparison has resulted in some sloppy conclu-

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[26] *See Facts About ALFA*, AM. LEGAL FIN. ASS'N., http://www.americanlegalfin.com/FactsAboutALFA.asp (last visited Mar. 3, 2012) (describing a voluntary agreement with the Attorney General of New York State and legislation in Maine and Ohio).

[27] *See Frequently Asked Questions*, AM. LEGAL FIN. ASSOC, http://www.americanlegalfin.com/faq.asp (last visited Mar. 3, 2012) ("An ALFA client can be anyone who has hired an attorney on a contingency fee basis to seek financial compensation for a personal injury suffered in an accident that wasn't their fault. Typically, the injury suffered has left them in financial hardship due to an inability to work. The consumer can contact one of the ALFA member companies directly to apply for legal funding or their Attorney may refer their clients to an ALFA member company when the client is experiencing financial distress during the course of his or her case. The client most often uses the funds received to make mortgage or rent payments, pay medical bills, purchase food, car payments, tuition, or basically anything else they need. Legal funding is used to pay for life's necessities.").

[28] *Id.*

sions. Thus, to draw an analogy between litigation funding and insurance defense requires a clearer picture of the insurance defense side.

We can envision two typical defendants. The first, an individual homeowner, purchases a homeowners insurance policy that includes personal liability and medical payments coverage. When a visitor is injured falling from the homeowner's deck, the policy provides coverage for the civil claim of injury and medical expenses. The protection goes beyond the home; if the policyholder unintentionally injures a person or causes property damage while out in the world, there may be coverage. In some sense, the liability sections of homeowners policies operate as liability insurance for individuals.

The second typical defendant is a corporation with a General Commercial Liability (CGL) policy. When a claim or suit is brought against the company, the insurer pays for both the defense and the damages award or settlement, subject to policy limits.[29] The relationship between the duty to provide a defense and the duty to pay proceeds in liability can be complex, but in general, the defense payments do not diminish the amount available to pay for damages or settlement.[30]

This article will spare the reader a treatise on the relationship and pitfalls between policyholder and liability insurer, but a few key elements of the set-up are important. Key aspects of the insurer defense relationship include:

(1) the contractual relationship precedes the litigation.
Thus,
(2) the insurer's involvement in the litigation is *automatic*,
not an investment *choice*, and
(3) litigation funding is not the primary purpose of the contract.[31]
Once a legal claim is made,
(4) the policyholder has a duty to cooperate with the insurer, and
(5) the policyholder and the insurer are co-clients of the lawyer.[32]

The first three aspects are relevant to the incentives the contractual relationship creates before litigation. The last two are central to the nature of that relationship in the throes of litigation.

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[29] It is possible to purchase a CGL policy that provides coverage for damage awards against the policyholder but *does not give the insurer either the right or duty to* participate in the litigation. These policies are generally only available to large sophisticated corporations in whose litigation expertise the insurer is confident. Of course, the policy still provides for safeguards of the insurer's interests.

[30] *See General Liability Insurance*, TECHINSURANCE, http://www.techinsurance.com/general-liability-insurance/ (last visited Mar. 3, 2012).

[31] Litigation funding is the primary or at least equal purpose of some insurance contracts, such as professional liability policies, which include medical malpractice and Directors & Officers insurance.

[32] *See infra* Part II.D.

A. (1)-(2) *Insurer Funding is Aleatory and Automatic If Triggered*

The relationship between the policyholder and insurer obviously begins when the policyholder purchases liability insurance. The insurer commits to the policyholder before he becomes a defendant in need of a legal defense. Indeed, the insurer commits before knowing whether the policyholder will ever need a legal defense. Like the insurer's obligation to indemnify, therefore, the insurer's obligation to provide a defense is aleatory. Unlike a third-party litigation funder, neither party to the contract knows at the time the contract is made whether any litigation will in fact be funded.[33]

If the policyholder does become a defendant, the insurer is pulled into the litigation by pre-existing contract. In stark contrast to a third-party litigation funder, the insurer does not have a choice whether to fund the defense or not. Having entered into the insurance contract, it is a comparison between the contract and the plaintiff's complaint that determines whether the insurer owes a defense.[34]

The insurer makes a promise to defend (and asserts the right to defend)[35] that is *not* based on the strength of the claimant's case.[36] If the act alleged in the complaint is one that falls within the scope of coverage, the insurer has an obligation to defend "even if the suit is groundless, false, or fraudulent."[37] The insurer does not first conduct a mini-trial only to join in the policyholder's defense if a finding of liability is likely. The duty to defend against potential liability is thus broader than the duty to compensate for liability.

This makes sense. If the policyholder is found liable after the insurer refuses a defense, the insurer will still be on the hook for the liability; the reasonableness of judging the claim to be groundless will not be a defense. "The duty to defend arises not from the probability of recovery but from its possibility, no matter how remote. Any doubt as to whether the allegations

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[33] This is a little simplistic on the commercial insurance side, especially for claims-made policies.

[34] This is the eight-corners rule, referring to the four corners of the insurance policy and the four corners of the plaintiff's complaint. *See* GuideOne Elite Ins. Co. v. Fielder Rd. Baptist Church, 197 S.W.3d 305, 308 (Tex. 2006). In certain jurisdictions the rule is not this simple. If the insurer has access to facts that show the true nature of the allegation to be under liability coverage, the insurer may have a duty to defend despite a poorly drafted complaint.

[35] *See generally* Douglas R. Richmond, *Liability Insurers' Right to Defend Their Insureds*, 35 CREIGHTON L. REV. 115 (2001).

[36] *See generally* James M. Fischer, *Insurer-Policyholder Interests, Defense Counsel's Professional Duties, and the Allocation of Power To Control the Defense*, 14 CONN. INS. L.J. 21 (2007).

[37] ISO, Homeowners 3–Special Form 16 (Homeowners 00 03 10 00) (2006). This language is common.

state a claim covered by the policy must be resolved in favor of the insured as against the insurer."[38]

Insurers may have other defenses, such as when a complaint only alleges intentional wrongdoing, which is excluded from coverage under the policy and by public policy.[39] An insurer may disclaim the duty to defend on the basis of a policyholder's breached duty to cooperate, although success will require a substantial and material breach.[40] But the insurer will not be deciding whether it would prefer to defend the policyholder's suit or invest the resources elsewhere.

In the ideal case, an insurer does not first learn of a suit when the complaint is filed; in order to investigate and create reserves, the insurer wants to be informed when the policyholder realizes it has committed an act that could lead to liability. Similarly, a plaintiff seeking funding can approach (or be approached by) a litigation funder either before or after the plaintiff has brought suit. The difference, of course, is that the litigation funder must decide whether to take on a contractual obligation to fund. The insurer has no such decision to make; its prior contractual obligation has been triggered by an event outside its control.[41] This difference is relevant to the insurers-as-litigation-funder's claim and the parity claim.

B. (3) *Litigation Funding Is Not the Primary Purpose of the Contract*

For an individual homeowner, the primary purpose of the contract is indemnification from damage to the home and personal items. Even if we optimistically assign the liability coverage equal billing, the litigation funding of a defense is at most half of the value of the liability coverage. Thus, with generosity, the litigation-funding portion of the contract is one-fourth of the purpose or value of the insurance policy to the policyholder. For a commercial policyholder, the litigation funding function is more valuable. While some homeowners are at best vaguely aware of their liability coverage, businesses purchase liability coverage in part to have protection against the cost of suit. With generosity again, we can even say that the

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[38] George Muhlstock & Co. v. Am. Home Assurance Co., 502 N.Y.S. 2d 174, 178 (N.Y. App. Div. 1986) (quoting Sucrest Corp v. Fisher Governor Co., 83 Misc. 2d 394, 404, .371 N.Y.S.2d 927, *affd.* 56 A.D.2d 564, 391 N.Y.S.2d 987).

[39] If the complaint alleges both intentional wrongdoing and, in the alternative, negligence, the duty to defend is usually triggered. *See, e.g.*, Sharonville v. Am. Emp'rs Ins. Co., 846 N.E.2d 833, 837-38 (Ohio 2006).

[40] *See* ROBERT H. JERRY, II & DOUGLAS R. RICHMOND, UNDERSTANDING INSURANCE LAW § 110 (4th ed. 2007).

[41] The same is true of before-the-event litigation expense insurance available in parts of Europe.

CGL policyholder values the litigation-funding portion at up to one-half the function of the policy.[42]

Nor is litigation funding the primary purpose of the contract for the insurer. Once a liability insurer's policyholder is charged by another party with potential liability, the insurer has a financial stake in the outcome of that dispute—whether the dispute settles or is resolved in litigation. This can be seen most clearly by considering a liability insurance contract in which the insurer takes no part in the litigation.[43] In these cases, the insurer retains the same financial stake in the outcome of the underlying litigation but maintains little or no control over the litigation.

With third-party litigation funding, the purpose of the contract is . . . litigation funding. The plaintiff seeks to shift litigation risk and the funder seeks to invest in the litigation; the path to both of these objectives is the financier's funding of the litigation. Burford Capital, and other investment funds, may add the function of increasing the chances of litigation success.

This difference in purpose matters in two ways. First, to the extent that third-party litigation funding has negative externalities that are difficult to measure, one might be inclined to restrict contracts with litigation funding as the goal more readily than contracts that include litigation funding. The most obvious externality of litigation funding will be an increase in litigation. Whether this is a negative externality is a large theoretical and empirical question that will not be answered here; litigation funding may primarily increase legitimate claims being brought and increase efficient settlement.[44]

While this debate plays out, the point to note here is that insurer *defense* funding does *not* obviously increase litigation. This difference between plaintiff litigation funding and defendant litigation funding is simple and powerful but easily overlooked.

With plaintiff litigation funding, an obvious first-line effect of the funding is to increase the number of claims brought. Again, whether it then increases the number of court cases, desirable settlements, or undesirable settlements is an empirical question. Liability insurance also increases the

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[42] For specific types of business that are more likely to be sued than to be liable, the litigation funding portion would be worth *more* than one half.

[43] It is possible to purchase a CGL policy that provides coverage for damage awards against the policyholder but does not give the insurer either the right or the duty to participate in the litigation. These policies are generally only available to large sophisticated corporations in whose litigation expertise the insurer is confident. Of course, the policy still provides for safeguards of the insurer's interests.

[44] *See* Jonathan T. Molot, *Litigation Finance: A Market Solution to a Procedural Problem*, 99 GEO. L.J. 65, 107 (2010); *see generally* Jonathan T. Molot, *A Market in Litigation Risk*, 76 U. CHI. L. REV. 367 (2009) (commercial defendant litigation funding); Anthony J. Sebok, *The Inauthentic Claim*, 64 VAND. L. REV. 61 (2011); Anthony J. Sebok, *Betting on Tort Suits After the Event: From Champerty to Insurance*, 60 DEPAUL L. REV. 453 (2011). *Contra* Catherine M. Sharkey, *The Vicissitudes of Tort: A Response to Professors Rabin, Sebok & Zipursky*, 60 DEPAUL L. REV. 695 (2011).

number of claims brought, but it is the funding of the *damage award*, and not the funding of the litigation, that attracts plaintiffs.[45]

Providing an otherwise judgment-proof tortfeasor with insurance increases substantially the value of bringing a claim against him. The effect of also providing a sophisticated, managed defense is less clear. Insurer management of a defense should please quality plaintiffs, in general, and displease weak plaintiffs or those looking for an easy settlement from a nuisance suit. In other words, the high quality of the defense should lead to more accurate settlements, which is good for those with strong cases and bad for weak ones.

In sum, the first rough effect of the difference in function of insurance and litigation funding contracts is that plaintiff litigation funding increases litigation, and insurance litigation funding does not. Second, the purpose of each contract affects the potential alignment of incentives for the funder. The insurer is more fully and evenly invested in the litigation than the third-party litigation funder. This does not necessarily mean the insurer's incentives are always better aligned than the litigation funder—far from it. It does mean that any claims about the workings of litigation funding based on the workings of insurer defense required detailed scrutiny.

Knocking aside all subtleties for the moment, we can envision a continuum of services for litigation stake and for litigation control. At one end of the spectrum is the lawsuit lender. The lender exerts no litigation control and is indifferent to the cost of litigation; his sole interest is in the fact of and amount of settlement or award. At the other end of the spectrum, imagine a litigation coach who has no stake in the outcome of the case; the coach's job is to help the litigant (plaintiff or defendant) get his desired outcome, which, roughly, will be maximizing the outcome while minimizing the cost of suit. The coach's pay for this job does not vary with the litigant's outcome. It is not a percentage of the damages awarded or saved. There is no premium for success, however defined, as there is in English conditional fee arrangements. Nor does the coach lend money to the litigant. In fact, let us assume the litigant has paid up front, so the coach has no reason to fear payment cannot be made if the suit fails. In other words, the coach has no financial stake whatsoever in the outcome of the litigation.[46] The lawsuit lender has no litigation control; the coach has total control. The lender's only stake is in the outcome of the litigation, whereas the coach has no stake in the outcome.[47]

The value of the fictitious litigation coach is two-fold. First, it fills the box of litigation stake = zero and litigation control at the high end, say 90%. Second, in the insurance defense context it is not fanciful. The in-

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[45] For a disturbing analysis of how insurance increases litigation, see KENNETH S. ABRAHAM, THE LIABILITY CENTURY: INSURANCE AND TORT LAW FROM THE PROGRESSIVE ERA TO 9/11 (2008).

[46] The coach has an obvious reputational stake in his client's view of the outcome.

[47] *See* Chart 1 for a visual representation of how these two stakes book-end the spectrum.

surer often controls the entire litigation from a client standpoint; the lawyer still has a role. Of course, the insurer is not a zero for litigation stake, as the coach is.

In contrast to the litigation coach, the lawsuit lender is a zero for control but very high for a stake in the settlement. "Lawsuit lender" here refers to an entity that lends a set amount of money to a plaintiff who already has an arrangement with a contingency fee lawyer. The lender has no control over the litigation. The lender has no stake in the cost of the litigation in that the lawyer is the lender for litigation cost purposes, and the lawsuit lender has lent a set amount that does not vary with litigation costs.

The following chart shows the position of various entities in three categories: how much control the party exercises over litigation and settlement decisions; how much of a stake compared to others involved the party has in the cost of litigation; and how much of a stake the party has in the case outcome, which here is assumed to be settlement. The percentages are not exact, with the exception of the zeroes and a few of the one hundred percentages.

CHART 1

Party providing litigation support	Litigation Control	Stake in Cost of Litigation	Stake in Settlement
"Lawsuit Lender"	0%	0%	20% - 60%[48]
Litigation Coach	90%	0%	0%
Liability Insurer	80% - 100%	100%	90% - 100%
Litigation Funder	0% - 50%?	80% - 100%	10% - 45%[49]
Contingency fee Lawyer	90%	100%	30%

The liability insurer could have a lower stake in the settlement depending on the case, of course; the 90-100% stake is more accurate for individual defendants and less accurate for commercial defendants. Likewise, it is not possible to put an exact percentage on the amount of litigation control an insurer exerts, although the control is high. It no doubt reaches full control (100%) for most individual tort plaintiffs. As discussed elsewhere, the

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[48] *See* Binyamin Applebaum, *Lawsuit Loans Add New Risk for the Injured*, N.Y. TIMES, Jan. 16, 2011, at A1, http://www.nytimes.com/2011/01/17/business/17lawsuit.html?pagewanted=all ("Unrestrained by laws that cap interest rates, the rates charged by lawsuit lenders often exceed 100 percent a year, according to a review by The New York Times and the Center for Public Integrity.").

[49] LAW 360, THE RISE OF 3RD-PARTY LITIGATION FUNDING (Jan. 21, 2011), *available at* http://www.jenner.com/system/assets/publications/130/original/The_Rise_Of_3rd-Party_Litigation_Funding.pdf?1312815913

insurer's stake in the settlement depends upon the likelihood of the settlement exceeding the policy limits. The insurer numbers are based on average cases.

The point of the chart stands even if we fill the insurer's numbers based on less common cases. The chart shows that the insurer's incentives are well-aligned. Where (as in most cases) the insurer is heavily invested in both litigation costs and settlement costs, the insurer does not have an incentive to minimize one at the expense of the other. Because the insurer is in control of the litigation, it keeps within its own cost and settlement interests. Unless there is misalignment because the policyholder has a substantial stake in the settlement, the insurer is poised to efficiently litigate and settle.

The policyholder–defendant may exert some litigation decision making in commercial cases and will share more of a stake in the final settlement or court award if the policy limit is reached, requiring the defendant to pay a portion of the costs directly. In a subset of cases, the policyholder's and insurer's interests are significantly misaligned because one bears the litigation costs and the other bears a large share of the settlement costs.[50] The point here, again, is not that insurer defense has no pitfalls, but that the pitfalls *differ* from those caused by third-party litigation funding.

C. (4) *The Duty to Cooperate in the Defense*

The policyholder's duty to cooperate with his insurer is usually written in the policy, but courts will imply the duty if it is not; the insurer's performance obligation is conditioned on the policyholder's cooperation.[51] Any lack of cooperation must be substantial and material to relieve the insurer of its duties. A key requirement of cooperation is that the policyholder may not settle the claim against it without the insurer's consent.[52] If the policyholder settles without the insurer's knowledge or against the insurer's will, the policyholder (usually) forfeits the insurer's settlement payment.

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[50] Indeed, Jonathon Molot's most convincing point in two excellent pieces is that commercial defendants may need additional litigation risk insurance. Molot, *A Market in Litigation Risk, supra* note 44; Molot, *Litigation Finance: A Market Solution to a Procedural Problem, supra* note 44.

[51] *See, e.g.*, Miller ex rel. Estate of Hott v. Augusta Mut. Ins. Co., 335 F. Supp. 2d 727 (W.D. Va. 2004), *aff'd*, 145 Fed. App'x 632, 638 (4th Cir. 2005) ("Under Virginia law, a duty-to-cooperate clause creates a condition precedent to an insurer's liability under the policy. A material breach of the duty to cooperate relieves the insurer of its liability under the policy, even if the insurer is not prejudiced by the lack of cooperation.").

[52] The requirement to cooperate in settlement comes from both the duty to cooperate and the subrogation clause. The subrogation clause is relevant because an insurer subrogated to its policyholder's claims has only those rights that the policyholder would have had; a policyholder who has settled may have no remaining rights, depending upon the various claims at issue.

In litigation funding, the plaintiff does not have a duty, at least not that we know of, to cooperate with the funder in any way regarding the litigation. In some states, courts "have held that a champerty contract that gives the power to settle to the funder" would permit impermissible intermeddling.[53] It is exceedingly likely that the plaintiff has a contractual duty, owed to the funder, to cooperate with the lawyers in pursing the claim. How the funder incentivizes the plaintiff to accept an appropriate settlement offer is unknown, but such incentives must exist for the funder to be willing to play.

As the relationship between funder, lawyer, and plaintiff evolves, it will become clearer if funded plaintiffs have a duty similar to that of insured defendants. On the other hand, the need for such a duty is surely lower. The plaintiff has every incentive to aid in the winning of the case; certain insured defendants may be recalcitrant to the hassle of involvement if the insurer is the one on the hook for the outcome. In insurance, the duty to cooperate also serves to combat a policyholder attempting to collude with a plaintiff at the insurer's expense.[54]

D. (5) *Co-Clients: Policyholder and Insurer*

The historic debate over whether insurance defense counsel has one or two clients is not entirely over, but in many ways insurers have won—the policyholder and the insurer are both considered clients.[55] "Today, absent a contrary agreement as to the identity of the client, the prevailing view appears to be that the lawyer represents both the insured and the insurer, at least for some purposes."[56] The insurer is not only integral to the defense decision making, it often runs the defense. Indeed, one of the services the insurer provides is that of repeat-player litigation expert; the insurer is familiar with common claims and has a network of lawyers and experts.

Third-party litigation funders vary in their stated and probable involvement in the underlying litigation. Given the newness of the funding in the United States, it is not clear what the precise relationship between the plaintiff and the funder is meant to be or how it actually manifests. The

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[53] Sebok, *The Inauthentic Claim*, *supra* note 44, at 110.

[54] *See* Lee R. Russ, *Post-Loss Rights & Duties; Adjustment of Loss*, *in* COUCH ON INSURANCE § 199:4 (2011) ("The main purpose of a cooperation clause is to prevent collusion while making it possible for the insurer to make a proper investigation.").

[55] This is not true in all states. For an important part of the debate, and an argument for allowing two clients, see Charles Silver, *Does Insurance Defense Counsel Represent the Company or the Insured?*, 72 TEX. L. REV. 1583 (1993).

[56] ABA Standing Comm. on Ethics & Prof'l Responsibility, Formal Op. 96-403 (1996). *See also* Harry M. Reasoner et al., *Conflicts in Insurance Defense Practice*, in BUSINESS AND COMMERCIAL LITIGATION IN FEDERAL COURTS § 65:53 (Robert L. Haig ed., 3d ed. 2011).

funder and the plaintiff, though, are clearly not co-clients of the plaintiff's lawyer.

At first blush, this difference between the litigation funder and the insurer seems fundamental and intractable. The insurer is a co-client not because it funds the litigation but because it will pay all or part of the defendant's damages owed.[57] The insurer's money is the money at stake in the litigation. The funder, on the other hand, cannot be a co-client because it has no stake in the underlying litigation. It has lent money to a person or entity who uses that money to bring a suit.

This description reveals the financial similarity between the plaintiff's funder and the defendant's insurer, however. The insurer's money is at stake; if the defendant loses, the insurer pays. The funder's money is at stake; if the plaintiff wins, the funder gains. Is the difference merely that one stands to lose and one stands to gain? One key difference is that in the average defendant's case, the insurer stands to pay nearly all, whereas in the average plaintiff's case, the funder stands to recoup only a portion of the proceeds, usually much less than half.

To further explore the difference between the two, consider each relationship in the absence of litigation funding. A policyholder could purchase a liability insurance policy that provided coverage for damages but not for defense funds. The insurer's funds would still be at stake in the outcome of the litigation. The insurer could still be a co-client of the (now policyholder-paid) lawyer. What differs dramatically in this scenario is the potential conflict between the policyholder and the insurer, in a way that shows the benefit of coupling insurer liability with insurer defense funding.[58]

If the policyholder pays defense costs but not liability, the policyholder will choose to minimize defense costs only, without regard for the final payment as long as it is within policy limits. The policyholder will thus settle as quickly as possible, avoiding defense costs and leaving the liability insurer to pay the settlement award. The liability insurer, on the other hand, who here is paying zero in defense costs, but paying all liability, will choose to minimize liability costs without regard to defense costs; the insurer will prefer an expensive court battle with dismal chances of success to a settlement where the insurer is guaranteed to pay. Joining the defense and liability costs primarily in one party—the insurer—creates a cleaner incentive to minimize the *joint* costs of defense and liability payment.

Returning to the plaintiff's litigation funder, removing the litigation funding alters the relationship beyond recognition. To preserve the investment aspect of the relationship, we can envision a third party who lends

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[57] In many cases, the policyholder (plus insurer) settles with the plaintiff within the policy limits, meaning that the insurer pays the entire amount, minus any deductible.

[58] More may be said on this point but the obvious observation is that a defendant who bears all the litigation costs and none of the settlement costs within the policy limits will settle at the policy limit as soon as possible, even if the expected value of the claim is much less.

money to the plaintiff. We can even envision that the lender is aware of the plaintiff's potential suit and views it as a potential asset. But the lender has no legal or contractual right to influence the plaintiff's litigation strategy or even to condition the loan upon pursuing the claim. The lender is not a co-client and would never be included in the suit as a party or brought into litigation discussions by the plaintiff's lawyer.

The purpose of this thought experiment, in part, is to reinforce trait (3) above: that litigation funding is not the central purpose of the policyholder-liability insurer contract. We can remove litigation funding from the relationship and retain the other key aspects of the relationship. But the main revelation the co-client status reveals is this: on one level the insurer is not a third party. Of course the insurer is not the party who committed an act triggering a liability suit. In all other ways, however, the insurer is fully involved in the litigation, perhaps with more at stake than the policyholder. Unlike the contingency fee lawyer, fund financier, or lawsuit lender, the insurer's involvement does not stem from the funding of the litigation and its stake precedes the funding decision.

III. THE COMPARISON CLAIMS

Accepting for the moment the value of the comparison between insurance defense and litigation funding, we can examine three claims that have been made on the basis of the comparison.[59] Do not necessarily blame litigation-funding supporters for any inconsistency among these claims; the claims come from various sources.[60]

First, insurers are third-party litigation funders (as are contingency fee lawyers). Thus, we can see that third-party litigation funding works well in

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[59] There are other claims about the relevance of insurance defense to litigation funding that will not be explored here. In a potential future of litigation funding for *defendants*, for example, the funding would operate as a form of insurance against the possibility of a large judgment.

[60] For each claim I have cited an individual or group who has supported the specific claim—but these claims are in the ether. Variants on each can be seen in the many recent symposia, conferences, or programs on third-party litigation funding. In addition to the 2009 RAND Civil Justice Institute Conference, RAND hosted "Alternative Litigation Finance in the U.S.: Where Are We and Where Are We Headed with Practice and Policy?," May 20-21, 2010. *See* STEVEN GARBER, ALTERNATIVE LITIGATION FINANCING IN THE UNITED STATES: ISSUES, KNOWNS, AND UNKNOWNS (2010), *available at* http://www.rand.org/pubs/occasional_ papers/2010/RAND_OP306.pdf. Erasmus University in Rotterdam hosted the conference "New Trends in Financing Civil Litigation in Europe: A Legal, Empirical and Economic Analysis," on April 24, 2009, and published a book based upon this conference. NEW TRENDS IN FINANCING CIVIL LITIGATION IN EUROPE: A LEGAL, EMPIRICAL, AND ECONOMIC ANALYSIS (Mark Tuil & Louis Visscher eds., 2010). Similarly, the Centre for Socio-Legal Studies and the Institute of European and Comparative Law University of Oxford organized an "International Conference on Litigation Costs and Funding," held July 6-7, 2009. *Costs and Mechanisms of Litigation Funding*, UNIV. OXFORD CTR. SOCIO-LEGAL STUDIES, http://www.csls.ox.ac.uk/FundingandCosts.php (last visited Apr. 13, 2012).

the United States already and should not cause alarm. Second, litigation funding is necessary on the plaintiff side to restore parity between plaintiffs and insurer-backed defendants. Supporters have not used this language, but one version of the claim is that insurer defense creates an imbalance with negative externalities. Third, insurer control of policyholder litigation is less intrusive than funder involvement will be. Because insurer control is accepted, a lower level of funder involvement should be as well.

A. *Comparison 1: Insurers are Litigation Financiers.*[61]

The claim that insurers already are third-party litigation financers is the most general of the comparisons between litigation funding and insurer defense. Time is better spent on the more detailed versions of this general claim. However, it is worth addressing initially because it has some intuitive appeal and some truth behind it. Moreover, as long as this position holds, casual observations about the insurance defense model will continue to seep into discussions of third-party litigation funding.

The assertion that insurers fund litigation already is true on two different levels. First, in England and some other jurisdictions, litigation expense insurance (LEI) bears a closer relation to third-party litigation financing. LEI comes in two basic forms: before-the-event (BTE) insurance and after-the-event (ATE) insurance, in which "the event" is litigation in want of funding.[62] LEI is usually purchased by the plaintiff, or plaintiff-to-be, but it can be purchased by a defendant. A plaintiff who purchases ATE litigation insurance has a litigation funder, as that term is used here, who is a third party and an insurer.

Unfortunately, this fact does not advance the discussion of potential third-party litigation funding in the United States. In the United States, litigation expense insurance is not widely available.[63] If it were, profitable comparisons could no doubt be drawn between ATE insurer litigation funding and ATE litigation funding by investors. As it is, the available comparison is between European insurers that fund (plaintiff) litigation expenses and American insurers that fund defense expenses as part of liability coverage. The differences between the European litigation context and the

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[61] *See, e.g.*, GARBER, *supra* note 60, at 2.

[62] *See* Willem H. van Boom, *Financing Civil Litigation by the European Insurance Industry*, *in* NEW TRENDS IN FINANCING CIVIL LITIGATION IN EUROPE, *supra* note 60, at 92; Morpurgo, *supra* note 10, at 353-54.

[63] In the United States, Sonoma Risk Insurance Agency, underwritten by Zurich, sells Contract Litigation Insurance (CLI). *See Contract Litigation Insurance*, SONOMA RISK INS. AGENCY, http://www.sonomarisk.com/node/4 (last visited Mar. 3, 2012). CLI covers the risk of having to pay the attorneys' fees of one's contracting partner under a "prevailing party" provision—in essence, when the parties have contracted around the American Rule. This coverage can be purchased by either the plaintiff or the defendant before or shortly after the start of litigation.

American one—including our tort system structure, higher litigation costs, and the American Rule—render this comparison difficult.[64] "Virtually every aspect of financing civil litigation in the United States differs from the European model, at least with regard to formal rules."[65] Moreover, as the analysis of the more specific claims below will show, scholars and policy makers are not drawing upon this comparison.

On a second, different level, the claim that insurers fund litigation could refer to subrogation. After an insurer has paid its policyholder for a loss, the insurer may by right or by contract pursue whatever claim the policyholder would have had against the party who caused the loss.[66] The insurer takes the role of plaintiff and funds what is now its own litigation. (Insurer subrogation thus might shed light on a discussion of expanded claim transfer in the United States). This will be discussed in more detail in a separate part, but for purposes of this claim it is important to note that subrogation is not the type of funding that is a competitor to or a substitute for all the various funding methods described as third-party litigation funding. Moreover, as with insurance defense litigation, the insurer's interest in the subrogated claim is pre-existing.

In short, the problem with the claim that insurers are litigation financiers is not its inaccuracy but its superficiality. Insurers obviously pay for legal costs in litigation. In the vast majority of cases, insurers do this either as co-clients of the lawyer representing the defendant or as plaintiffs with claims in subrogation. In other words, the insurer is either not a third party or is *the* party as a result of claim transfer. The difference between these relationships and third-party litigation funding does not mean that the two should never be mentioned in the same breath. It does mean that in an analysis of third-party litigation funding, little can be said to automatically follow from the fact that insurers fund litigation.

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[64] Third-party litigation funding has been present in England (over ten years) and Australia (over twenty years) for longer than it has been in the United States. The background in which litigation funding takes place in those countries differs quite dramatically from the United States. In England, for example, the losing party pays the winning party's litigation costs and contingency fees are prohibited, although conditional fee arrangements have recently been permitted. In addition, until recent cutbacks, publicly provided legal aid allowed many individual plaintiffs to bring suit. There are other relevant differences, but these alone are sufficient to alter the need for and the effect of litigation funding.

[65] Deborah R. Hensler, *Financing Civil Litigation: The US Perspective*, *in* NEW TRENDS IN FINANCING CIVIL LITIGATION IN EUROPE, *supra* note 60, at 149.

[66] *See generally* Spencer L. Kimball & Don A. Davis, *The Extension of Insurance Subrogation*, 60 MICH. L. REV. 841 (1962). Equitable subrogation may be limited as equity requires. The insurance contract can provide the right to "conventional" subrogation, although whether conventional subrogation can apply when equitable subrogation would not is a question of some debate. Subrogation is not limited to insurance, of course. When a surety pays a creditor to satisfy a debtor's debt, the surety is subrogated to the creditor's original claim against the debtor.

B. *Comparison 2: Restoring Parity Between Policyholders and Defendants*

Some "question the fairness of the defendant's ability to transfer risk to an insurance company before the event, while plaintiffs are left to absorb all the risk of returns on their claims until the eventual outcome."[67] While fairness may be in the eyes of the beholder, it is useful to examine the potential effects of evening out what may be a lopsided arms race between plaintiff and defendant. First, however, it is worth examining the breadth of the factual claim, both in the commercial and individual context.

In both contexts, there will be defendants who cannot rely on an insurance company to provide a defense. For the individual, the largest set of uninsured suits will be those brought for intentional harms. Whether it is the act, the outcome, or both that must be "expected or intended from the standpoint of the insured" to exclude coverage depends on the policy, but mostly on the jurisdiction.[68] In the majority of jurisdictions, courts require an intentional act and some level of intent to cause injury, although intent can be inferred and the intent to cause a lesser harm will apply to a worse outcome.[69] The saving grace for some defendants is not the level of intent required, but the propensity of plaintiffs to bring suits arguing intentional harm and, in the alternative, unintentional harm. Such mixed suits often do trigger an insurer-provided defense.[70]

For the commercial defendant, the largest set of uninsured suits may be those brought for contract disputes and breach of contract. In non-contractual disputes between commercial entities, both parties will likely have CGL insurance and other forms of commercial coverage. In many of these cases the plaintiff is not left to absorb all the risk until the eventual outcome; the plaintiff may recover under its own insurance and then support the insurer in its subrogation claim against the defendant. In this scenario, the plaintiff receives some compensation for the harm before suit and moves some or all of the risk of suit to its insurer. In many circumstances, then, a defendant will not be able to transfer the risk of suit to an insurer and a plaintiff will be able to transfer some risk of suit.

Nonetheless, in plenty of cases the plaintiff will have to bear his own litigation risk while the defendant has been able to transfer some of his risk

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[67] RAND CONFERENCE 2009, *supra* note 2, at 53 (Appendix B: Presenter Materials, from Keynote Speech by Lord Daniel Brennan).

[68] *See* JERRY & RICHMOND, *supra* note 40, § 63C.

[69] *Id.* § 63C[a].

[70] Indeed, plaintiffs may plead in the alternative for the purpose of bringing the tortfeasor's insurer into the picture. An otherwise judgment-proof defendant may be worth suing if the plaintiff either can convince the insurer that winning on the unintentional claim is likely enough to merit settlement or that settling a mixed claim early on will be less expensive than proving in court that the policyholder's actions were intentional and not indemnified.

to an insurer. The insurer also brings a trait that proponents of third-party litigation funding wish to extend to plaintiffs: risk neutrality. Without insurance, a risk-averse defendant is not indifferent between a known settlement of $50,000 and a 50% chance of a $100,000 damages award even though the expected value is identical; he may settle for $60,000 to avoid the risk of owing $100,000.[71] This works to the obvious advantage of the plaintiff.

Having taken this advantage away from the plaintiff through insurance defense, should we restore parity (if that is what it does) by allowing the plaintiff to transfer his litigation risk? For individual plaintiffs, the question is what value litigation funding will add over contingency fee arrangements; lawsuit lending will give some plaintiffs the resources and time necessary to continue a suit he would otherwise be forced to settle "early." For commercial plaintiffs, the question of parity also comes down to efficient settlement. Litigation funding may increase the accuracy of settlements so that they are based on the parties' expectations about the value of the suit and not a reflection of one party's risk preferences.[72] This is the strongest point that emerges from the comparisons between insurer defense and litigation funding.

Whatever the value of risk neutrality on the part of a plaintiff, the value of coupling litigation cost with liability insurance is high. Assume a scenario in which the plaintiff's payment is expected to be below the policy limits; the policyholder has no fear of an award or settlement going up to that limit. If we imagine a policyholder who has liability insurance coverage for the award or settlement, but *not* for lawyer's fees, he will want to settle as quickly as possible for two reasons. First, going to trial gains him nothing because a damages award of either less than the settlement offer or zero only benefits the insurer. Second, going to trial or any other choice that keeps the lawyer employed is a direct cost borne by the plaintiff alone. This scenario has assumed the possibility of settlement (the most likely outcome) and settlement at or below insurance policy limits (a common

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[71] The literature on why and when parties settle is deep. *See, e.g.*, William M. Landes, *An Economic Analysis of the Courts*, 17 J.L. & ECON. 61 (1971); John P. Gould, *The Economics of Legal Conflicts*, 2 J. LEGAL STUD. 279 (1973); Samuel R. Gross & Kent D. Syverud, *Getting to No: A Study of Settlement Negotiations and the Selection of Cases for Trial*, 90 MICH. L. REV. 319 (1991); Bruce L. Hay, *Effort, Information, Settlement, Trial*, 24 J. LEGAL STUD. 29 (1995); Russell Korobkin, *Aspirations and Settlement*, 88 CORNELL L. REV. 1 (2002).

[72] For a thorough presentation of this argument, see Molot, *Litigation Finance: A Market Solution to a Procedural Problem*, *supra* note 44. Professor Molot is now also the Chief Investment Officer of Burford Group Limited, the largest litigation investment fund in the United States. *See supra* notes 12, 17, 20 and accompanying text. At Burford, Prof. Molot is also a Managing Director and Chairman of the Investment Committee. This is not to question Prof. Molot's belief in the value of third-party litigation funding; indeed, he has put more than his money where his mouth is.

outcome). In short, decoupling the insurer's liability burden from the litigation cost burden results in higher and more inaccurate settlements.[73]

Professor Stephen Yeazell makes a related parity claim that litigation funding will make "plaintiffs parallel with defendants whose insurers are implicitly vouching for the credibility of the defense."[74] If insurers do vouch for the credibility of a defense by mounting one, it provides "credibility" in a limited sense. And it pales in comparison to the credibility that a litigation funder provides by agreeing to invest in a plaintiff's case.

The value of credibility here is the ability to bring the other party to a favorable settlement. Insurers have a duty to defend a case, whereas third-party funders have a choice; their choice to invest in a claim sends a strong signal.[75] (One can imagine, however, a signal that is blurred by hedging. A litigation fund could invest in both sides of an open legal question, perhaps if the legal winds seem to change after the initial investment is made).

The insurer's signal is much more ambiguous. An insurer's decision to be involved in a policyholder's defense is not based on the merits of the case. It is the decision to settle, and at what price, that reveals something of the insurer's opinion of the case. However, the vast majority of civil litigation settles, including the vast majority of civil suits against tortfeasors with liability insurance. Eventual settlement may thus be presumed by both sides. A willingness to delay coming to a settlement may not reveal much either, as the insurer may be working from a belief in the strength of the case or the luxury of taking a negotiating position.

In this sense, an insurer does provide some credibility; it is harder to force a defendant to settle out of the inability to bear litigation risk when a more risk-neutral party is involved. If both the plaintiff and the defendant could pursue and defend a claim without cost, settlement decisions would be more "pure" in that they would reflect more accurately the parties' view of the strength and value of the claim. Instead, each party chooses a settlement point that takes account of litigation costs and negotiation costs, where litigation risk is one of the costs. Stated in this way, the value of credibility parity is the same point as the value of each party making decisions from a point of risk-neutrality.

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[73] Note that while the policyholder prefers immediate settlement the insurer may prefer a full trial. The closer the expected settlement to the policy limit, the more an insurer has to gain from even a tiny chance of success at trial. The policyholder bears the full burden of the trial's legal costs and the insurer's expected damages payment decreases.

[74] RAND CONFERENCE 2009, *supra* note 2, at 130 (Appendix B: Presenter Materials, from Stephen C. Yeazell's presentation "Third Party Finance: Legal Risk and Its Implications"). Prof. Yeazell is an expert on civil litigation and one should assume his full view is more nuanced than this sentence, which is taken from a PowerPoint presentation. That said, the idea that litigation funding will equalize the negotiating position of plaintiffs with insurer-backed defendants is a common one.

[75] One can imagine, however, a signal that is blurred by hedging. A litigation fund could invest in both sides of an open legal question, perhaps if the legal winds seem to change after the initial investment is made.

C. *Comparison 3: In Litigation, If Insurer Control is Acceptable, Mere Investor Involvement Must Be Even More So*

Insurers interject themselves into settlement decisions in defense actions; litigation funding will be less intrusive and thus we need not worry about interfering with either the lawyer's or the client's legal judgment. This comparison speaks to ethical concerns that litigation funding will interfere with the lawyer's duty to his client and legal concerns that funding asymptotically approaches claim transfer, which is permitted but restricted in the United States. This claim has been made about, and makes the most sense with, investor funds, not lawsuit lenders who lend to individual tort plaintiffs.

For example, in discussing the ethical concerns about litigation funding, Nathan Crystal has argued that funders should be allowed the contractual right to *advise* lawyers and clients on settlement, but not the right to decide. In considering the general purpose of the American ethical rule against fee-splitting (lawyers sharing fees with non-lawyers), Crystal's focus is on allowing the lawyer to make independent legal judgments in his client's best interest:

> The insurance defense practice is an important model that can be used for comparison here. The insurance company retains the right to decide whether to accept or reject a settlement, except perhaps in medical malpractice cases. If anything, the financing arrangements discussed here are less intrusive on the attorney-client relationship.[76]

This claim is unsatisfactory on both sides of the comparison. On the insurer side, it is not simply that insurers have more control over their policyholder's defense; insurers have more at stake in the litigation and play a more equal role as co-client. On the fund side, it is not at all clear that investor funds do or will maintain the lower level of influence that Crystal and others advocate. Overlaying the comparison is the fact that one side is initiating litigation and one side is responding; it may be that third-party intervention in one raises concerns not raised by the other.

Taking the funder side first: skepticism about the ability of a funder to "advise" but not influence the outcome of a case is natural. This risk seems especially high if the lawyer or law firm and funder are repeat players; the lawyer who does not take advice on when to settle may expect to avoid the advice in the future by having no further dealings with the funder. Some have thus gone farther than Crystal, arguing that a funder should be completely excluded from the legal process so that litigation funding can have

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[76] RAND CONFERENCE 2009, *supra* note 2, at 17-18 (summarizing Crystal's remarks).

"the benefits of champerty without the downside."[77] For now, the casual reports of these arrangements place the funder lawyers "in the room" with the plaintiff-borrower and their litigation attorney during discussions, including settlement decisions.

On the insurer defense side of the comparison, it is not as simple as noting that if insurer control of litigation is acceptable, then funder influence that stops short of control is acceptable as well. In a sense, the relationship between insurer and defendant is horizontal integration and the relationship between plaintiff and funder is vertical integration. Thus the potential conflicts that arise in the insurance relationship differ from those in third-party financing. The claims that the ethical considerations are similar have been too quick. In addition to the pre-existing alignment of the policyholder's and insurer's interests—as opposed to the prior estrangement of the litigant and third-party financier—both the insurance contract and the common law charge the policyholder and the insurer with cooperation and fiduciary duties toward one another.

Most important, the insurer's stake is often much higher than the defendant's while the litigation funder's stake is always less than the plaintiff's. Given this, one would expect more and different problems with increased funder control of the litigation. If the funder's control exceeds its stake in the litigation, it will be tempted to privilege its interests over the plaintiff's when they diverge.

In addition, unlike the funded plaintiff, the policyholder–defendant has the opportunity to gain at the hands of the insurer. The insurer must be concerned about collusion between their policyholder and the plaintiff. The policyholder's incentive is not to minimize the amount the plaintiff receives, but rather to minimize the amount the policyholder pays. Thus, the insurer must monitor the policyholder's behavior. The insurance contract usually states the policyholder's duties to cooperate in litigation, seek agreement on settlement, etc. Likewise, the insurer's incentives can easily misalign with the policyholder's. Unlike the third-party financier, who is on the hook for litigation costs, the insurer is potentially on the hook for litigation costs and the final judgment awarded by a court or jury. It is also possible for the litigation to reveal facts that relieve the insurer of any duty to pay, again, unlike third-party financiers.

Next, the insurer and the financier play different roles in their support and instigation of litigation. As discussed, the insurer's duty to defend in most policies extends to baseless claims with little chance of success as long as the allegations are within the policy coverage. After the policy coverage is set, insurers do not get to choose which cases to fund. Financiers, on the other hand, select their cases. Furthermore, if the policyholder's and insurer's interests diverge, the duty to defend becomes a duty to pay for the

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[77] RAND CONFERENCE 2009, *supra* note 2, at 19 (summarizing remarks by Kathleen Flynn Peterson).

defense; the insurer ceases to control the litigation.[78] (A common example occurs when a plaintiff alleges both negligent and intentional conduct. The insurer would benefit from a finding of intentional conduct, which in most cases ends insurance coverage. The defendant policyholder obviously prefers a finding of no tort or negligence to intentional conduct.) Third, and perhaps most obviously, an insurer funding the defense of a case will not have the same potential effect on the quantity or type of litigation as funding plaintiffs' instigation of suit.[79] In short, between insurer involvement in policyholder litigation and third-party litigation financing, there are differences in structure, incentives, ethical rules and questions, and likely effect.

D. *Assignment Versus Investment*

Another difference stems from the level of insurer control over the litigation. At first look, the insurer's domination of their policyholder defendants should be scandalous. The insurer manages to inhabit the small space between claim transfer and champerty without fully committing either of them.[80] The first reason the insurer is given a pass is that "defense transfer" is not claim transfer. In contrast to the huge judicial and scholarly energy spent on trying to decide if, how, and when to permit the assignment of claims, there is little said about defense transfer.

"[T]he central issue around which the distinction between the practice of selling claims and [third-party litigation funding]—in its 'narrow' sense—is control over the litigation."[81] For individual defendants, insurers exert such a high level of control over the litigation that the law would label it as claim transfer or assignment if it were a claim.[82] For commercial de-

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[78] A common example occurs when a plaintiff alleges both negligent and intentional conduct. The insurer would benefit from a finding of intentional conduct, which in most cases ends insurance coverage. The defendant policyholder obviously prefers a finding of no tort or negligence to intentional conduct.

[79] The existence of liability insurance coverage creates strong incentives to sue and to create of new torts. *See generally* ABRAHAM, *supra* note 45. But this incentive stems from the insurance coverage itself, not from defense funding.

[80] Champerty is "[a]n agreement between an officious intermeddler in a lawsuit and a litigant by which the intermeddler helps pursue the litigant's claim as consideration for receiving part of any judgment proceeds." BLACK'S LAW DICTIONARY 262 (9th ed. 2009). Three related concepts are well explained here: "'[P]ut simply, maintenance is helping another prosecute a suit; champerty is maintaining a suit in return for a financial interest in the outcome; and barratry is a continuing practice of maintenance or champerty.'" Osprey, Inc. v. Cabana Ltd., 532 S.E. 2d 269, 273 (S.C. 2000) (quoting In re Primus, 436 U.S. 412, 424 n.15 (1978)).

[81] Morpurgo, *supra* note 10, at 356.

[82] Anthony Sebok states that "full control of the lawsuit collapses the distinction between maintenance and assignment." Sebok, *Inauthentic Claim*, *supra* note 44, at 109. This is correct in every way but one: in assignment the assignee internalizes *all* the costs as well as the *benefits* of pursuing the claim, while the litigation funder who controls the litigation still shares the benefit of suit with the

fendants control over the litigation is likely more evenly shared, although insurers retain the *right* to defend and a *veto* over settlement.[83]

In other words, insurers and policyholders engage in what might be called defense transfer or defense assignment.[84] Why call it defense transfer instead of defense control? A claim holder can pay a third party to manage its litigation or it can transfer the claim. In transfer, the new owner alone benefits from a positive settlement or award. In insurer defense of individual policyholders, it is largely the insurer alone who pays the settlement or award. The ability to settle a claim against the policyholder's wishes smacks of an insurer with a property right in the claim over the policyholder. In the commercial general liability context, the policyholder is more likely to share some of the burden. On a continuum between claim or defense transfer and litigation support, insurer defense is approaching transfer and third-party litigation funding is not.

This lack of claim transfer is fundamental to litigation funders. Effectuating claim transfer is tricky.[85] Personal injury claims in tort cannot be assigned at all; given the existence of contingency fee arrangements in the United States, third-party litigation funding for the tort plaintiff might not exist were assignment permitted. Some of the claim areas that investment funds have focused on would be extremely difficult or impossible to achieve in the form of transfer, such as antitrust claims and shareholder disputes.[86]

CONCLUSION

This article rejects the basic claim that if insurer defense is a net social and economic benefit, then litigation funding must be a net benefit as well. Insurer defense funding stems from an existing relationship with a separate aim. Once a policyholder is charged with potential liability, the insurer has a financial stake in the outcome of that dispute, whether it settles or is re-

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claim-holder. Perhaps the distinction is trivial because in the first instance the assignee pays the claim-holder for the claim up front and in the second the funder "pays" the claim-holder after a win, with payment in the form of taking only a portion of winnings. Where the timing of payment affects incentives, however, the distinction is not trivial.

[83] For an excellent discussion of settlement control in the contingency fee context, see Neil Rickman, *Contingent Fees and Litigation Settlement*, 19 INT'L REV. L. & ECON. 295 (1999).

[84] The concept of a "defense transfer" is an obvious one, but only one other author has used the phrase. *See* Maya Steinitz, *Whose Claim Is This Anyway? Third-Party Litigation Funding*, 95 MINN. L. REV. 1268 (2011).

[85] Two outstanding articles on property rights in claims and claim transfer generally are Michael Abramowicz, *On the Alienability of Legal Claims*, 114 YALE L.J. 697 (2005) and Sebok, *Inauthentic Claim*, *supra* note 44.

[86] *See Claim Sectors–How We Work*, JURIDICA CAPITAL MGMT. LTD, http://www.juridica.co.uk/claim.php (last visited Feb. 21, 2012).

solved in litigation. The policyholder and the insurer are co-clients of their lawyer, and the one who controls the litigation spending, the insurer, likely has the largest stake in the litigation outcome.

Third-party litigation financing introduces a new party into the litigation relationship, one that at the margin engenders the litigation. The new party also remains an outsider; the litigation funder does not control the cost of the litigation and may have no hand in litigation decisions. The points of possible tension between funder and client differ from the tension points between insurer and policyholder. At a minimum, this means that the cost–benefit analysis in the two cases must diverge. While tensions and direct conflicts can follow from either third-party financing or insurer litigation, the cost of constraining litigation funding is unknown. Because it is not possible to avoid the conflicts in insurance without banning liability coverage, the cost of fundamentally altering the liability coverage system is unfathomable.[87]

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[87] *But see* Alan I. Widiss, *Abrogating the Right and Duty of Liability Insurers to Defend Their Insureds: The Case for Separating the Obligation to Indemnify from the Defense of Insureds*, 51 OHIO ST. L.J. 917 (1990).

THE WHAC-A-MOLE GAME: AN EMPIRICAL ANALYSIS OF THE REGULATION OF LITIGANT THIRD PARTY FINANCING

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Forthcoming in Vol 25 of Theoretical Inquiries in Law (2024)

Abstract

Using a unique private dataset from one of the largest consumer litigation financing firms in the U.S., we are the first to explore the impact of states' regulatory activity (statutory or judicial) on funders' behavior and consumers' welfare. Our comprehensive dataset includes data on over 105,000 third party funding agreements from 2000 throughout 2020 and data we compiled ourselves from court decisions, state legislation, and regulatory actions.

Our analysis shows that laws or court decisions that loosen restrictions on LTPF are generally associated with greater funding activity, while restrictions on the interest rate funders can charge are associated with an almost 15% reduction in funding activity. However, in the cases that are funded, the funder tries to circumvent restrictions on the funding agreement by altering other terms. For example, when legislation prohibits compounding or limits how long funders can charge interest, the funder responds by increasing the posted monthly interest rate. Although these interest rate increases are not enough to completely offset the impact of the other restrictions on the funder's returns, the funder nevertheless has higher returns than it would have without the attempted circumvention.

More generally, our analysis reveals that restrictive court rulings and regulations generally induce funders to either leave the jurisdiction or to adjust other terms in the funding agreement in an effort to maintain their returns. Like in the classic Whac-A-Mole game, funders try to maintain their pre-regulation per-funding-return no matter how states' regulatory activity tries to get rid of it. Although the funder is not always successful in circumventing regulation, policymakers must be aware of funders' responses to restrictive regulation to ensure that policies are achieving their desired result. Our results also suggest that reducing the regulatory uncertainty of funding can lead to more available and cheaper LTPF for consumers.

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I. INTRODUCTION

Third-party litigation finance, in which a lender advances money as a nonrecourse loan to support plaintiffs' litigation, is a rapidly maturing industry that has become an integral part of our legal system. Increasingly, policy makers and scholars have called for regulation of the industry to protect vulnerable consumers/plaintiffs. Indeed, some state courts have imposed judicial restrictions and some legislatures have enacted laws regulating the industry. Unfortunately, these regulations and restrictions have been based more on good intentions or isolated anecdotes than on actual data. There has been very little empirical research on the third-party litigation finance industry, and no research has examined the impact of state regulatory activity on actual funding practices. This project attempts to fill that void.

Using a unique private dataset from one of the largest consumer litigation financing firms in the U.S., we are the first to explore the impact of states' regulatory activity (statutory or judicial) on funders' behavior and consumers' welfare. Our comprehensive dataset includes data on over 105,000 third party funding agreements from 2000 throughout 2020 and data we compiled ourselves from court decisions, state legislation, and regulatory actions. We hypothesize that when states regulate LTPF agreements, either through legislation or court decision, funders' reaction depends on how prohibitive the regulation is and whether loopholes exist. When the regulation is prohibitive, such as a law imposing a low cap on interest rates, and no loopholes exist, we hypothesize that funders will likely leave the state. In contrast, when the regulation is lenient, such as a law only requiring disclosure, we believe funders won't change their practices. Alternatively, when the regulation is prohibitive but loopholes exist, we hypothesize that funders will adjust the non-salient factors in their funding agreements to restore their pre-regulation revenues. For example, funders may respond to caps enacted on the posted interest rate, by altering their compounding method or imposing various types of early exit fines or processing fees.[4] If funders are able to circumvent all or some of the regulations, then past regulation of the industry may not have been as effective as regulators expected.

Our analysis shows that laws or court decisions that loosen restrictions on LTPF are generally associated with greater funding activity, while restrictions on the interest rate funders can charge are generally associated with less funding activity. However, in the cases that are funded, the funder tries to circumvent restrictions on the funding agreement by altering other terms. When legislation prohibits compounding or limits how long funders can charge interest, the funder responds by increasing the posted monthly

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[4] In other contexts, lenders have been found to respond to regulations restricting certain contractual terms by altering other contractual terms in an attempt to offset the regulation's impact. For example, credit card issuers responded to The Credit Card Accountability, Responsibility, and Disclosure Act of 2009 (which restricted the charging of credit card fees and the increasing of interest rates for a specified time period) by offering cards with lower fees but higher interest rates. See, e.g. Song Han, Benjamin J. Keys, & Geng Li, *Information, Contract Design, and Unsecured Credit Supply: Evidence from Credit Card Mailings*, FEDS Working Paper No. 2015-103, at 26 (2015).

interest rate. Although these interest rate increases are not enough to completely offset the impact of the other restrictions on the funder's returns, the funder nevertheless has higher returns than it would have without the attempted circumvention.

Our analysis also shows that even voluntary agreements to regulate LTPF, the funder adjusts terms to offset changes in other contractual terms. Unlike the other states, in New York restrictions on LTPF result from a voluntary agreement between an LTPF trade group and the state Attorney General. The agreement did not impose caps on the interest rate or restrictions on other terms in funding agreements; it only required the clear disclosure of certain terms. After this voluntary agreement,

Our analysis shows that, even under voluntary agreements to regulate LTPF, the funder adjusts terms to offset changes in other contractual terms. Unlike the other states, in New York restrictions on LTPF result from a voluntary agreement between an LTPF trade group and the state Attorney General. The agreement did not impose caps on the interest rate or restrictions on other terms in funding agreements; it only required the clear disclosure of certain terms. After this voluntary agreement, our funder increased funding in New York, presumably because the funder viewed the minor disclosure requirements under the agreement as more favorable than the uncertainty about how LTPF might be regulated before the agreement was reached. The funder also lowered the posted interest rate while raising the early exit penalties consumers have to pay for LTPF. Although the higher penalties partially offset the impact of lower interest rates, overall the funder received lower returns on its funding after the voluntary agreement. The funder's increase in funding activity and acceptance of lower returns suggest that the voluntary agreement's reduction in regulatory uncertainty make funding more attractive in New York.

More generally, our analysis reveals that restrictive court rulings and regulations generally induce funders to either leave the jurisdiction when they can not circumvent regulation or to make adjustments to other terms in the funding agreement in an effort to maintain their returns. Although the funder is not always successful in circumventing regulation, policymakers must be aware of funders' responses to restrictive regulation to ensure that policies are achieving their desired result. Moreover, our New York results suggest that legislation or agreements that reduce the regulatory uncertainty of funding can lead to more available and cheaper LTPF for consumers.

II. THIRD-PARTY LITIGATION FUNDING: EVOLUTION AND DEBATES

Third-party litigation is essentially a cash advance on a judgement or settlement award. Once a dispute arises, plaintiffs can seek funding from a third-party financier to help offset the expense of legal bills, cover costs such as medical bills or lost wages, or just to monetize part of their legal claim. The funding is generally "non-recourse" such that the plaintiff doesn't have to pay back the financier if they lose their case. However, if the litigation results in either a settlement or monetary judgement, the financier is paid directly out of the litigation proceeds.

Third-party litigation finance operates differently depending on the plaintiff receiving the funding. Consumer litigation finance is funding for an individual's litigation, usually a personal injury case. In contrast, commercial litigation finance is the funding of litigation between business entities. In commercial litigation finance, funding is generally provided either directly to the attorneys or to the business litigants for the explicit purpose of paying the attorneys and other legal costs. In contrast, in consumer settings, funding is typically provided directly to the individual plaintiff to help them cover basic living expenses or medical bills during the pendency of litigation. Because consumer litigation finance provides financial support to the litigant themselves, we call this type of funding "litigant third-party finance" (LTPF). LTPF is the focus of this article.

The world-wide litigation funding market, including both LTPF and commercial litigation finance, was estimated to be over $12 billion in 2021 and is expected to reach over $25 billion by 2030.[5] Yet the industry is still relatively new. Third-party litigation finance, as we know it today, started in Australia in the mid-1990s as a way to raise funding for corporate insolvency cases. The practice then spread to class actions, which had been legalized in 1992,[6] and, in 2006, the Australian High Court explicitly legitimized litigation finance outside of insolvency cases by holding that the practice was not an abuse of process or contrary to public policy.[7]

Litigation financing began at about the same time in the United Kingdom after a series of laws had legalized various aspects of third-party funding. The country had decriminalized champerty and maintenance in 1967[8] and allowed litigants to enter non-recourse conditional fee agreements in 1990.[9] In 1999, the UK both created a loser-pays rule for legal costs and allowed litigants to purchase insurance to cover their opponent's legal costs if they lost, thus allowing all legal costs to be funded by third parties.[10] After the UK Court of Appeals effectively approved litigation financing in a 2022 decision, the industry quickly expanded.

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[5] https://www.globenewswire.com/en/news-release/2022/08/29/2506137/0/en/Global-Litigation-Funding-Investment-Market-Size-Worth-25-8-Billion-by-2030-at-a-9-CAGR-Custom-Market-Insights.html

[6] Federal Court of Australia Amendment Act 1991 (Cth)

[7] Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd (2006) 229 CLR 386

[8]

> Maintenance, champerty and barretry finally ceased to be criminal offences and torts by virtue of sections 13 and 14 of the Criminal Law Act 1967, following recommendations made by the Law Commission, which described maintenance and champerty as dead letters that were no more than useless "lumber" that "ought to be discarded in practice". . .

David Neuberger, *From Barratry, Maintenance and Champerty to Litigation Funding*, Harbor Litig. Funding (May 8, 2013), https://www.harbourlitigationfunding.com/wpcotent/uploads/2015/09/lord_neuberger_harbour_annual_lecture_8_may_2013.pdf at ¶ 15.

[9] Criminal Law Act of 1967; Courts & Legal Services Act, 1990, § 58 (Eng.)

[10] Access to Justice Act of 1999

In the U.S., litigation finance evolved separately for consumer and commercial litigation. Consumer LTPF started in the late 1980s and early 1990s as states began to examine and overrule their prohibitions on champerty and maintenance.[11] In contrast, commercial litigation started in 2006 with Credit Suisse's 2006 Litigation Risk Strategies group, and became visible in 2008 when Juridica launched the first publicly-traded litigation finance firm. [12]

Litigation finance is appealing to both individuals and business entities because it allows litigants to share both the cost and the risk of litigation with third parties. Litigation is prohibitively expensive for most individual plaintiffs,[13] but even wealthy companies would prefer to offset the risk and expense of litigation in return for sharing some of the upside of successful litigation.[14] Although contingency fee arrangements allow plaintiffs to pass litigation costs to their attorneys, most law firms are not liquid enough to finance the litigation expenses of an unlimited number of cases.[15] Third-party funders can provide this additional liquidity.

Moreover, LTPF provides distinct benefits that commercial litigation finance does not. Unlike most business entities involved in litigation, individual plaintiffs often struggle to pay non-litigation expenses, such as medical bills or living costs, while they wait for a settlement or judgement. LTPF helps these plaintiffs cover expenses while they await disposition of their cases. In many circumstances, the availability of LTPF improves access to justice by enabling plaintiffs to reject poor settlement offers that they might otherwise have no choice but to accept in order to pay the bills.

Despite the benefits litigation finance provides to plaintiffs, critics have raised a number of concerns about the implications of third-party funding on our justice system. Many have argued that third-party litigation finance incentivizes the filing of frivolous claims. For example, the U.S. Chamber's Institute for Legal Reform has asserted that third-party funders "can be expected to have higher risk appetites than most contingency-fee attorneys and to be more willing to back claims of questionable merit." [16] In response,

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[11] S*ee, e.g.,* Susan Lorde Martin, *Syndicated Lawsuits: Illegal Champerty or New Business Opportunity?,* 30 AM. Bus. L.J. 485 (1992); Donald L. Abraham, Note, *Investor-Financed Lawsuits: A Proposal to Remove Two Barriers to an Alternative Form of Litigation Financing,* 43 SYRACUSE L. Riv. 1297 (1992); *Financing Inventors' Lawsuits,* N.Y. TIMES, Mar. 11, 1989, at 36.

[12] Suneal Bedi and William C. Marra, The Shadows of Litigation Finance, 74 Vanderbilt L.R. 563, 565 (2021) VANDY ARTICLE, Maya Steinitz, Incorporating Legal Claims, 90 NOTRE DAME L. REV. 1155, 1164 (2015)

[13] See, e.g.,Emery G. Lee III, Law Without Lawyers: Access to Civil Justice and the Cost of Legal Services, 69 U. MIA. L. REV. 499, 503 (2015) (explaining how increasing litigation costs are an obstacle to access to justice).

[14] Joanna M. Shepherd & Judd E. Stone II, Economic Conundrums in Search of a Solution: The Functions of Third- Party Litigation Finance, 47 ARIZ. ST. L.J. 919, 923-929 (2015)

[15] Joanna M. Shepherd & Judd E. Stone II, Economic Conundrums in Search of a Solution: The Functions of Third- Party Litigation Finance, 47 ARIZ. ST. L.J. 919, 929-932 (2015)

[16] U.S. CHAMBER INST. FOR LEGAL REFORM, STOPPING THE SALE ON LAWSUITS: A PROPOSAL TO REGULATE THIRD-PARTY INVESTMENTS IN LITIGATION 4 (2012), https://www.instituteforlegalreform.com/uploads/sites/1/TPLF_Solutions.pdf.

scholars have pointed out that third-party investors have a strong incentive to avoid frivolous cases that are unlikely to return the same profit that meritorious cases would.[17] Critics have also argued that, because litigation finance makes more funding available to plaintiffs to bring legal claims, the practice will expand litigation in our already-stretched civil justice system.[18]

Others have raised ethical concerns about third-party litigation finance, asserting that it increases the likelihood that third parties will interfere with the litigants' control over the litigation or attorney-client privilege.[19] For example, the Chamber's Institute for Legal Reform has claimed that a third party investor "presumably will seek to protect its investment, and can be expected to try to exert control over the plaintiff's strategic decisions" and, thus, litigation finance "places the power to make strategic decisions about [litigation] in the hands of the funder."[20] To avoid these ethical concerns, many financiers explicitly reject involvement in any litigation or settlement decisions. Moreover, Rule 18(f) of the ABA Model Rules of Professional Conduct prohibits a lawyer from accepting third-party compensation unless "there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship."[21]

Critics also have concerns that are specific to LTPF. Unlike commercial litigation finance in which third-party funders enter agreements with sophisticated and experienced business entities, LTPF involves funding agreements between funders and consumers who may have no experience with funding contracts or litigation. As a result, consumers are at risk of not realizing what they've agreed to, either because the agreement is lacking in transparency or because consumers simply don't understand the terms of the agreement.[22] Even worse, consumers may enter into a funding agreement that is not in their best

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[17] Joanna M. Shepherd & Judd E. Stone II, Economic Conundrums in Search of a Solution: The Functions of Third- Party Litigation Finance, 47 ARIZ. ST. L.J. 919, 950-951 (2015); Jason Lyon, Comment, Revolution in Progress: Third-Party Funding of American Litigation, 58 UCLA L. REV. 571, 593-594 (2010).

[18] See, e.g., Jeremy Kidd, To Fund or Not to Fund: The Need for Second-Best Solutions to the Litigation Finance Dilemma, 8 J.L. ECON. & POL'Y 613, 627–29 (2012); Paul H. Rubin, Third-Party Financing of Litigation, 38 N. KY. L. REV. 673, 675 (2011).

[19] Julia H. McLaughlin, Litigation Funding: Charting a Legal and Ethical Course, 31 VT. L. REV. 615 (2007)

[20] U.S. CHAMBER INST. FOR LEGAL REFORM, STOPPING THE SALE ON LAWSUITS: A PROPOSAL TO REGULATE THIRD-PARTY INVESTMENTS IN LITIGATION 4-5 (2012), https://www.instituteforlegalreform.com/uploads/sites/1/TPLF_Solutions.pdf' U.S. CHAMBER INST. FOR LEGAL REFORM, SELLING LAWSUITS, BUYING TROUBLE: THIRD-PARTY LITIGATION FUNDING IN THE UNITED STATES 8 (2009), available at http://perma.cc/3S5J-59JR. The particular aspect of control over the litigation may vary, depending on the particular inflection points that may matter to the funder. For example, a funder might want, like a liability insurer, some (or total) control over settlement. It may want to control the selection of substitute counsel if the current lawyer withdraws.

[21] MODEL RULES OF PROF'L CONDUCT r. 1.8(f) (AM. BAR ASS'N 1983).

[22] Ronen Avraham, Lynn A. Baker, and Anthony J. Sebok, The MDL Revolution and Consumer Legal Funding, 40 The Review of Litigation, 143, 153-154 (2021)

interest.[23] For example, the interest rate on the advanced funds may be so high that even victorious plaintiffs are left with nothing after the funder takes their cut.[24]

III. REGULATION OF LTPF

The concerns raised about litigation finance, and especially LTPF, have prompted a variety of state attempts to regulate the industry through either legislation or judicial pronouncement, depending on the political circumstances in each state. Although many states regulate consumer and commercial litigation finance in the same way, in this Article we focus on only state regulation of consumer LTPF.

Some states consider LTPF to be champerty and ban it under their champerty laws. Champerty is "an agreement to divide litigation proceeds between the owner of the litigated claim and a party unrelated to the lawsuit who supports or helps enforce the claim."[25] Along with the doctrine of maintenance, the "[i]mproper assistance in prosecuting or defending a lawsuit given to a litigant by someone who has no bona fide interest in the case; meddling in someone else's litigation," champerty laws were adopted in medieval times to prevent frivolous litigation.[26] Although some states have abolished their champerty laws, others have determined that LTPF constitutes illegal champerty. For example, in 2016, the Superior Court of Pennsylvania ruled that the litigation funding agreement was void as champerty by Pennsylvania's law: "An agreement by a stranger to defray the expenses of a suit in which he has no interest or to give substantial support and aid thereto in consideration of a share of the recovery or the proceeds thereof is condemned by the courts as champertous."[27]

At the other end of the spectrum, some states have explicitly decided that LTPF is allowed. These states have generally abolished or never adopted champerty laws, or they do have champerty laws but have determined that LTPF is not champerty. For example, in 2008, the North Carolina Court of Appeals rejected a claim that a litigation funding agreement was illegal champerty: "A litigation funding agreement under which defendant creditor advanced money to plaintiff borrower that was to be repaid out of plaintiffs expected recovery in a pending personal injury claim was not void as constituting champerty and maintenance."[28] With similar effect, in 2008, the state of Ohio enacted legislation that allowed "contracts for a non-recourse civil litigation advance."[29]

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[23] Susan Lorde Martin, Litigation Financing: Another Subprime Industry That Has a Place in the United States Market, 53 VILL. L. REV. 83 (2008)

[24] Jenna Wims Hashway, Litigation Loansharks: A History of Litigation Lending and a Proposal to Bring Litigation Advances Within the Protection of Usury Laws, 17 Roger Williams U. L. Rev. 750 (2012).

[25] *Champerty*, BLACK'S LAW DICTIONARY (11th ed. 2019).

[26] *Maintenance*, BLACK'S LAW DICTIONARY (11th ed. 2019); *See, e.g.*, Bluebird Partners, L.P. v. First Fidelity Bank, N.A., 731 N.E.2d 581, 585 (N.Y. 2000); Osprey, Inc. v. Cabana Ltd. Partnership, 532 S.E.2d 269, 273 (S.C. 2000).

[27] WFIC, LLC v. LaBarre, 2016 PA Super 209, 148 A.3d 812 (2016)

[28] Odell v. Legal Bucks, LLC, 192 N.C. App. 298, 665 S.E.2d 767 (2008)

[29] Ohio Rev. Code § 1349.55

Among the states that explicitly allow LTPF, some states have prohibitive regulations in place while other states have virtually no limitations. Some states have determined that LTPF is a loan, and thus are regulated under state usury laws which typically restrict the interest rate. Other states have not determined that usury laws apply but, nevertheless, have adopted other restrictions on LTPF. These restrictions often include limitations on the interest rate, the maximum loan duration, service fees, and the compounding frequency. Other common regulations require funders to make certain disclosures to consumers and prohibit funding agreements from including choice of law provisions that would allow the parties to agree that a different state's law governs the agreement. For example, in 2019, West Virginia enacted legislation that limits the annual fee charged in LTPF agreements to 18% of the original amount of money provided to the consumer.[30] The legislation further restricts the frequency of compounding to twice a year[31] and limits the term for which interest can accrue to 42 months.[32] The agreement must include certain disclosures,[33] and prohibits choice of law clauses.[34]

Finally, many states have not enacted any legislation regulating LTPF nor issued any judicial decisions limiting the practice. In these states, LTPF is presumably allowed and unregulated.

Although there is a growing body of scholarly research on third-party litigation finance, there have been only three published empirical articles.[35] All three of these articles have been co-authored by two of us and utilize private data provided by one of the largest LTPF funders in the U.S.[36] In the earliest of these articles, Avraham and Sebok exposed

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[30] West Virginia Code § 46A-6N-9(a) ("A litigation financier may not charge the consumer an annual fee of more than 18 percent of the original amount of money provided to the consumer for the litigation financing transaction").

[31] West Virginia Code § 46A-6N-9(c) ("Fees assessed by a litigation financier may compound semiannually but may not compound based on any lesser time period").

[32] West Virginia Code § 46A-6N-9(e) ("A litigation financier may not assess fees for any period exceeding 42 months from the date of the contract with the consumer").

[33] West Virginia Code § 46A-6N-5("A litigation financing contract shall contain the disclosures specified in this section, which shall constitute material terms of the litigation financing contract").

[34] West Virginia Code § 46A-1-104("This chapter applies if a consumer, who is a resident of this state, is induced to enter into a consumer credit sale").

[35] Ronen Avraham & Anthony J. Sebok, *An Empirical Investigation of Third Party Consumer-Litigant Funding*, 104 CORNELL L. Rev. 1133 (2019); Ronen Avraham, Lynn A. Baker & Anthony J. Sebok, *The Mysterious Market for Post-Settlement Litigant Finance*, 96 N.Y.U. L. Rev. Online 181 (2021); Ronen Avraham, Lynn A. Baker, and Anthony J. Sebok, *The MDL Revolution and Consumer Legal Funding*, 40 The Review of Litigation, 143 (2021). There are two published empirical studies about the LTPF industry in Australia (David Abrams & Daniel Chen, *A Market for Justice: A First Empirical Look at Third Party Litigation Funding*, 15 U. PA. J. Bus. L. 1075 (2013) and Daniel Chen, *Can Markets Stimulate Rights? On the Alienability of Legal Claims*, 46 RAND J. ECON. 23 (2015)). There is also one unpublished dissertation. Jean Y. Xiao, An Empirical Examination of Consumer Litigation Funding (May 2017).

[36] We believe that the data provided by the funder is a very good proxy for the TPLF market for two reasons. First, the funder was one of a very small number of funders that comprised a very large share of

the pricing schemes of LTPF funders that includes not just the posted interest rate, but also less salient factors such as various fees and exit fines, the type of compounding, and the inclusion of interest buckets and minimum interest periods (both of the latter terms are types of early exit penalties).[37] These pricing schemes are often too complex and opaque for consumers to understand. For example, they found that funding agreements that advertise the interest rate as less than 50% per annum actually result in final amounts due to the funder of more than 115%.[38] In this Article, we use the same private dataset to explore the impact of states' regulatory activity on funders' behavior and consumers' welfare.

IV. DATA AND ANALYSIS

A. Data Description

To measure the impact of state regulatory activity on funding agreements, we merge the private data provided by one of the largest LTPF funders in the U.S. with data we collected on state regulatory activity. **[40]**

Our analysis of the private data examines funding agreements in over 105,000 cases over the years 2000-2020.[41] The requests for funding were made by plaintiffs in a variety of personal injury lawsuits: motor vehicle accidents (68,033 cases), slip and fall accidents (10,134 cases), labor lawsuits (7,661 cases), premises liability (6,628 cases), medical devices (4,313 cases), medical malpractice (3,590), assault or police brutality (2,508) cases, and products liability (2,352 cases). All of these requests were brought by plaintiffs before

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the total market. Given that there are no publicly available reports from any of the TPLF funders in the United States disclosing the size of their market or the characteristics of their contracts, we can only offer a rough estimate of the relationship between the funder and the entire market, but we believe that it may comprise 33% of the total consumer TPLF market. Second, the funder operated nationally, and clearly had the opportunity to advertise in every state and contract with consumers in any state where it felt it could operate legally and at a profit.

[37] Ronen Avraham & Anthony J. Sebok, *An Empirical Investigation of Third Party Consumer-Litigant Funding*, 104 CORNELL L. Rev. 1133 (2019).

[38]

> [T]he best explanation [for processing fees is to] hide[] their true cost from the imperfectly rational client. . . . [In addition] multidimensional pricing (compounding interest, MIP, IB) . . . serve as tools to reduce the perceived total costs to the consumer. Consumers' cognitive biases simply prevent them from being able to price these terms into the perceived total price of the contract, even if they were aware of these terms.

Id. at 1172–73.

[40] All of the data presented in this section (and the is drawn from the same data set used (and presented) in Avraham & Sebok, *An Empirical Investigation of Third Party Consumer-Litigant Funding*, *supra* note 37.

[41] For a full discussion of the data, see Ronen Avraham & Anthony J. Sebok, *An Empirical Investigation of Third Party Consumer-Litigant Funding*, *supra* note 37.

their cases were settled. Of the funding agreements, 77,486 were "completed," meaning the funding request went through the underwriting process, the client was funded, the case settled, and the funder was repaid. Another 17,254 cases were "funded," but the funder had not been repaid during the period of our data. Finally, 10,479 of the agreements, or 10 percent of the total, were "refused" by the plaintiff; the requests went through the underwriting process and a funding offer was made to the plaintiff, but the plaintiff did not take the funding. The average age of the funded plaintiff is 42, and the agreements fund cases in all 50 states, but residents of New York account for almost half of the total.

Of the completed cases in our data, the median amount funded was $1,500 and $3,313 was the median amount due to the funder after the case settled, reflecting a markup of 120%.[42] For these completed cases, the median number of days that elapsed between the date of the accident and when the plaintiff contacted the funding company was 445 days. Then the funding company took only a median of 8 days to fund the request. The entire underwriting process that includes investigating the case facts, the plaintiff, the lawyers, the court hearing the case, and the defendant's insurance coverage was completed during this period. From this investigation, the funder estimates the case's value; the median estimated value of completed cases was $75,000.[43] After the funding was extended to plaintiffs, a median of 441 days elapses before the case settled and the funder was repaid.

The 120% median markup on the completed cases is the result of several different features of the funding contracts. To begin, there is a monthly interest rate. The median posted monthly interest rate in the completed cases in our dataset is 3.15%. Plaintiffs presumably assumed that, with this posted monthly rate, the annual rate of interest was about 38%. However, this would only be the case if the funder did not compound monthly, which it did in 85% of completed cases. With monthly compounding of a 3.15% posted monthly interest rate, the annual interest rate would actually be 45%. However, most funding agreements weren't completed in a year; the median length of a completed funding agreement was 441 days, or 14.5 months. With monthly compounding of a 3.15% posted monthly interest rate, the total interest rate for the median 14-month case would be 57%.

The next factors contributing to the 120% median markup are the minimum interest period and interest buckets, which are effectively penalties on early repayment of the funding. The minimum interest period refers to how many months of interest the plaintiff will have to pay even if the case settles immediately. In our dataset, the median minimum interest rate was almost 3 months, meaning the plaintiff paid at least 3 months of interest, compounded monthly, even if the case settled the day after funding was extended. At our median monthly posted interested rate of 3.15% with monthly compounding, the plaintiff was committed to paying 9.8% to satisfy the 3-month minimum interest period. The interest buckets are the intervals after the minimum interest period for which the plaintiff will be charged interest even if the funder is repaid during the interval. The median interest bucket in our completed cases was also 3 months, meaning that if the funder was repaid after 3

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[42] The average amount funded in the completed cases was $3,452 and the average amount paid back to the funder was $5970, reflecting a 73% percent markup.

[43] The mean estimated case value was $336,000.

months and 1 day, the plaintiff was responsible for paying 6 months of interest. Similarly, if the funder was repaid after 6 months and 1 day, the plaintiff was responsible for paying 9 months of interest.

The final factor culminating in the median 120% markup are fees. The application (or processing) fee is incurred at the time of contracting, before the plaintiff and funder know whether the case will yield any proceeds. But the funder does not collect the fee until the case is resolved – in other words, only once the plaintiff and funder know that the case has yielded proceeds. That is because the contract specifies that the funder advances the fee as well as the underlying cash advance secured by the payment of the fee. The median fee was found to be $150, or 10% of the $1,500 median amount funded.[44] If a case settled for a high enough amount that a plaintiff was responsible for paying fees, the contract provided that the fees were suddenly treated like an advance, even though the amount of the fee was not advanced, and the cost of the advance was compounded by the same terms of the rest of the amount funded. This means that a $150 fee on a case with a posted monthly interest rate of 3.15%, compounded monthly, and with 14.5 months elapsing before the funder is repaid will actually be $235, or over 15% of the $1,500 median amount funded.

We merge our private data on funding agreements with data we collected on each state's regulatory activity. We conducted an exhaustive examination of all court decisions, legislation, and agency actions in each state to determine all activity impacting LTPF between 2000-2020.

For each state between 2000 and 2020, we determined both the legal status of LTPF and any restrictions on LTPF agreements. We divided the legal status of LTPF in each state into one of five categories: LTPF is prohibited, LTPF is allowed but regulation is prohibitive, regulation of LTPF is lenient, LPTF is allowed with no regulation, and states in which there are no laws or decisions concerning LTPF so it is presumably allowed.

LTPF was prohibited for at least part of our sample period in 8 states.[45] In these states, either the black letter law or a court prohibited LTPF because proceeds from personal injury claims could not be assigned in the state or because LTPF was prohibited as champertous or against public policy. Nevertheless, in all states but Ohio, our funder continued to fund cases. Our research suggests that our funder did not think that the law applied to LTPF funding as practiced by the funder, believing, for example, that the law applied only to the full assignment of claims rather than the partial assignment under a LTPF contract.[46]

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[44] Ronen Avraham & Anthony J. Sebok, *An Empirical Investigation of Third Party Consumer-Litigant Funding*, 104 CORNELL L. Rev. 1133 (2019).

[45] Alabama, Arizona, Kansas, Kentucky, Mississippi, Missouri, Nevada, and Ohio.

[46] It is also possible that our funder believed that it could avoid violating the local law in some or all of these states by relying on choice of law clauses in their TPLF contracts that adopted the law of a state where TPLF was clearly permitted, such as New York.

During at least part of our sample period, LTPF was explicitly allowed with no regulation in 15 states.[47] In these states, a court had decided that LTPF was allowed—either because the doctrine of champerty had never been adopted, champerty had been overruled, or because the court decided that LTPF was not champerty—and no laws or regulations restricting the terms of LTPF agreements had been enacted. Moreover, in 35 states, there were no laws or court decisions concerning LTPF for at least some years during our sample. Without any laws explicitly prohibiting or restricting LTPF, it was presumably allowed and unregulated.

In another 5 states, LTPF was technically allowed but regulation of LTPF was prohibitive, and in 11 states, LTPF was allowed with only lenient regulation.[48] In these states, a court had similarly decided that LTPF was allowed, but a law or regulation had been enacted that restricted the terms of the LTPF agreement. We divided these states into those with prohibitive regulation and those with lenient regulation depending on the cap imposed on the interest rate. Without any restriction on the interest rate charged in LTPF agreements, the funder charged an average annual interest rate of 36 percent. Some states enacted regulations or had court decisions that significantly reduced the interest rate that could be charged for LTPF funding. For example, in 2015 Arkansas enacted legislation that capped the annual interest rate in LTPF agreements at 17 percent.[49] In North Carolina, a court in 2008 decided that LTPF was subject to the state's Consumer Finance Act that restricted the annual interest rate to 16 percent.[50] We coded these and other states with annual interest rate caps below 36 percent as having prohibitive regulation.[51]

In other states, regulations were passed that did not restrict interest rates in LTPF funding agreements below the average interest rate that was already charged. For example, in 2019 Nevada enacted a statute that capped interest rates at 40 percent annually.[52] In 2007, Maine enacted a statute that allowed only semiannual compounding and limited the maximum loan duration to 42 months, but did not restrict the interest rate in LTPF agreements at all.[53] We coded these and similar states as leniently regulated.

In addition to the status of LTPF in each state, we also coded for legislation or regulation restricting the specific terms in the funding agreement. Specifically, we determined whether legislation/regulation had been enacted that restricted the annual interest rate that could be charged in LTPF, that prohibited the use of compounding, that

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[47] States that allowed LTPF with no regulation include: California, Colorado, Connecticut, Delaware, Florida, Georgia, Illinois, Massachusetts, Michigan, Minnesota, Montana, New Hampshire, New Jersey, Pennsylvania, and South Carolina.

[48] States that allowed LTPF with prohibitive regulation include: Arkansas, Colorado, Maryland, North Carolina, and West Virginia. States that allowed LTPF with lenient regulation include: Indiana, Maine, Nebraska, Nevada, New York, Ohio, Oklahoma, Tennessee, Utah, Vermont, and Wisconsin.

[49] Ark. Code § 4-57-109

[50] Odell v. Legal Bucks, LLC, 192 N.C. App. 298, 665 S.E.2d 767 (2008); N.C. Gen. Stat. § 24-1.1(a)(1)

[51] We include states that consider LTPF to be usury and restrict interest rates under usury laws at below 36 percent, even if the states don't directly regulate the LTPF industry.

[52] Nev. Rev. Stat. Ann. § 604C.310 (West).

[53] Me. Stat. tit. 9-A § 12

limited how often interest could compound, or that restricted the maximum duration for which interest could be charged. The status of each state's regulatory framework in 2020 is provided in two tables in the Appendix.

B. Empirical Analysis

To measure the impact of each state's restrictions on LTPF agreements, we estimate the relationship between various dependent variables and our treatment and control variables. The dependent variables in our analysis are: the number of newly funded cases in each state each year, the posted monthly interest rate in the individual LTPF contracts, and the weighted annualized rate of return to the funder from the closed agreements.[54]

In our state-level estimations of the number of newly funded cases each year, we use treatment variables that reflect the overall status of LTPF in the state and treatment variables measuring legislative or regulatory restrictions on the terms of the funding agreement. The variables reflecting the status of LTPF include an indicator variable for whether LTPF is explicitly allowed and unregulated, and indicator variable for whether there have been no laws or court decisions concerning LTPF so it is presumably allowed, and an indicator variable for whether LTPF is allowed and only leniently regulated. The omitted variables in our estimations are indicators for whether LTPF is prohibited or LTPF is allowed but regulation is prohibitive. Thus, the estimations will treat these variables as the baseline and measure how funding activity in states with no regulation or lenient regulation compares.

The treatment variables measuring individual restrictions on the terms of the funding agreement include whether there is a cap on the total annual interest charged to the plaintiff (this is a cap on both the regular interest and the interest that can be charged for service), whether compounding of interest is prohibited, whether there is a limit on how often interest can compound, and whether there is a limit on the maximum months that interest can be charged. In our agreement-level estimations of the posted monthly interest rate and the weighted annualized rate of return, we use only the treatment variables measuring individual restrictions to determine whether the funder circumvents restrictions on some terms by altering other terms.

As control variables, we include the gender of the plaintiff, the age of the plaintiff, the squared age, indicator variables for the case type (motor vehicle accidents, medical malpractice, etc.), and state and year fixed effects.[55] We use linear regressions in all estimations. We estimate separate regressions for each treatment variable, and cluster

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[54] The weighted annualized rate of return is measured as the [(the returns to the funder -the amount funded)/the amount funded] * [365/the number of days funding is outstanding], weighted by the amount funded.

[55] Gender is estimated based on clients' names, using Gender-Api.com. In the estimations of the number of newly funded cases in each state/year, the control variables are the state-level proportions (of gender and the case type variables) or state-level averages (of the age variables).

standard errors by state to reflect the fact that observations may be independent across groups (clusters), but not necessarily within groups.

We present separate results for funding agreements involving cases located in the states excluding New York and then for funding agreements involving cases located in New York. New York is unique among the states we studied because restrictions on LTPF result from a voluntary agreement between an LTPF trade group and the state Attorney General.[56] The restrictions in this agreement did not impose significant burdens on the industry and allowed it to operate, in fact, almost exactly as it had up to that point.[57] Reporting separate results allows us to determine the funder's response to the voluntary New York restrictions versus its response to restrictions imposed by legislatures, agencies, or courts in other states. Table 1 reports summary statistics for the dependent variables across the different subsets of the data.

Table 1: Summary Statistics[58]

	Excluding NY	NY only
Average Number of newly funded cases per year	345 (297.6)	3186 (953.6)
Posted monthly interest rate	3.08 (.474)	2.87 (0.526)
Weighted Annualized rate of return	0.577 (1.63)	0.512 (0.046)

As Table 1 shows, the funder funded many more cases in New York than the average number of cases it funded in other states. In fact, almost half of the funded agreements in our data are from New York. Because of the absolute size of New York, as a well as the relative maturity of the LTPF industry in that state, competition was and is intense among funders. Therefore, it is not surprising that the average posted interest rate and the annual rate of return are lower in NY.

Table 2 reports the number of states that had each LTPF status or legislative/regulatory restriction at some point during our sample. As several states changed status during our sample period, these numbers exceed the total number of states.

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[56] See Attorney Gen. of N.Y., Bureau of Consumer Frauds & Prot., *Assurance of Discontinuance Pursuant to Executive Law § 63(15)* (Feb. 17, 2005).

[57] See, e.g. Jenna Wims Hashway, *Litigation Loansharks: A History of Litigation Lending and a Proposal to Bring Litigation Advances Within the Protection of Usury Laws*, 17 ROGER WILLIAMS U. L. REV. 750, 775 - 82 (2012).

[58] Notes: Each cell reports the mean and standard deviation.

Table 2: Number of States with each Decision or Restriction During our Sample

	Number of states
Status of LTPF	
LTPF is prohibited	8
LTPF is allowed but regulation is prohibitive	5
LTPF is allowed with lenient regulation	11
No laws or decisions pertaining to LTPF	35
LTPF is allowed and not regulated	15
Legislative/Regulatory Restrictions	
Cap on total annual interest	10
Compounding prohibited	7
Limit on number of months interest can be charged	5

1. *Results for States Excluding New York*

a. *Funding Activity*

We first examine whether the status of LTPF or restrictions on the terms of the funding agreement are associated with the amount of funding activity in the states other than New York. Particularly negative decisions or onerous restrictions on the funding agreements may cause the funder to reduce the amount of cases it funds, or even leave the state altogether.

For example, in Colorado, Kentucky, and Minnesota, the funder completely stopped funding cases after negative court rulings. On November 16, 2015, following a legal battle of more than five years, the Colorado Supreme Court ruled that LTPF is a loan subject to usury laws that limit the interest rate. The funder, who had already dramatically reduced its activity following a negative district court ruling in 2011, completely left the state after the supreme court decision. Similarly, in Kentucky, the United States District Court for the Western District of Kentucky Bowling Green Division ruled on Mar 30, 2017 that LTPF agreements are prohibited as champerty. The funder left immediately after without waiting for the appellate court to affirm the judgment two years later. In Minnesota the District Court ruled on May 5th, 2014 that LTPF is prohibited as champerty. The Funder left shortly after.[59] In two other states, North Carolina and Pennsylvania, courts

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[59] In 2020 the Supreme Court of Minnesota reversed the lower court decision, ruling that LTPF is allowed. However, we have no funding data after this date to determine whether the funder returned to funding in the state.

also ruled that LTPF is a loan subject to usury laws. In both states, the funder reduced its funding activity, but did not leave the state altogether.[60]

Similarly, legislation that places onerous restrictions on the terms of the funding agreement could also induce a funder to reduce or cease funding activity. For example, when Arkansas enacted legislation in 2015 setting a maximum 17% interest rate, the funder stopped doing business in the state altogether. Similarly, in 2014, Tennessee enacted a law that prohibited compounding, limited the time that interest could be charged to 36 months, and capped total annual interest at 46% per year. As a result, the funder stopped funding cases in Tennessee in 2015, and didn't start again until 2018 after the state enacted a law that was more pro-funder. As another example, in 2016 Indiana enacted a law that prohibited compounding, capped total annual interest at 43% per year, and capped extra fees at $500. Within 2 years, the funder was funding less than 20% of the cases it had been funding at its peak in 2013.

To examine whether certain court decisions or restrictions on funding agreements systematically impact funding activity across all states, we estimate the relationship between the number of new cases the funder funds each year and our treatment and control variables. Our treatment variables include variables reflecting the status of LTPF: indicator variables for whether LTPF is allowed with no regulation, presumably allowed, or leniently regulated. We also include as treatment variables the individual restrictions on the terms of the funding agreement: whether there is a cap on the total annual interest rate charged for the funding, whether compounding of interest is prohibited, whether there is a limit on how often interest can compound, and whether there is a limit on the maximum months that interest can be charged on the funded amount.

Table 3 reports the results. All control variables are included in the analysis, but their results are not reported in the table for brevity. The full results for all tables are reported in Appendix 3. The results indicate that laws or court decisions that loosen restrictions on LTPF are associated with greater funding activity. Compared to states that prohibit or prohibitively regulate LTPF, there are an average of 50 additional cases funded in states where LTPF is presumably allowed because there have been no laws or court decisions concerning LTPF. The results suggest that there are also additional cases funded in the states that explicitly allow LTPF without regulation, although the coefficient on this variable is not statistically significant. Given an average of 347 newly funded cases each year, the results indicate approximately a 14 percent increase in funding in states with looser restrictions.

Table 3: The Relationship between Funding Activity and the Treatment Variables[61]

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[60] We believe this can be attributed to both states allowing choice of law clauses that allow the funder to indicate that the funding agreement is governed by the laws of another state.

[61] Notes: Each cell reports the coefficient from the linear regression with its standard error in parentheses. ***, **, and * denote coefficients that are significant at the 99%, 95%, and 90% level, respectively.

	Number of Funded Agreements (Excluding NY)
Status of LTPF	
No laws or decisions pertaining to LTPF	49.995** (24.258)
LTPF is allowed & leniently regulated	-0.226 (15.014)
LTPF is allowed and not regulated	30.634 (25.904)
Legislative/Regulatory Restrictions	
Compounding frequency limited	-32.723* (18.454)
Compounding prohibited	-54.744* (29.80)
Limit on # of months interest charged	-20.422 (19.364)
Cap on total annual interest	-51.698** (23.372)

The results also indicate that one of the individual restrictions on terms in the funding agreement—interest rate caps—is associated with less funding activity. Interest rate caps are associated with almost 52 fewer funded cases each year, representing about a 15 percent decrease compared to the average of 347 newly funded cases each year. As expected, the coefficients for the other restrictions are negative, yet are not statistically significant.

b. The Posted Interest Rate

Next, we investigate whether, in those states in which our funder continued its business, it responded to restrictions on funding terms by adjusting other terms in the agreement. We estimate the relationship between the posted monthly interest rate in the contract (including both the interest rate on the funding and the interest rate charged for service) and the treatment variables that measure individual restrictions on the terms of the funding agreement.

Table 4 reports the results. Again, all control variables are included in the analysis, but their results are not reported in the table for brevity.

Table 4: The Relationship between the Posted Interest Rate and the Treatment Variables[62]

	Posted Monthly Interest Rate (Excluding NY)
Compounding frequency limited	0.001 (0.040)
Compounding prohibited	0.257*** (0.071)
Limit on # of months interest charged	0.155*** (0.042)
Cap on total annual interest	0.205*** (0.064)

The results indicate that several legislative or regulatory restrictions on the terms in the LTPF contract have a positive and significant relationship with the posted monthly interest rate. For example, when legislation prohibits compounding or limits how long funders can charge interest, funders respond by increasing the posted monthly interest rate. The magnitudes of the coefficients show the percentage point increase in the monthly interest rate when each restriction is enacted. For example, if a law is enacted that limits the months that interest can be charged, funders respond by, on average, increasing the monthly interest rate by 0.155 percentage points. At the average posted monthly interest rate of 3%, this increase represents approximately a 5% increase. These results suggest that funders respond to regulation that restricts one term in the funding agreement by adjusting other terms to maintain their pre-regulation returns.

Perhaps counterintuitively, at least at first glance, a cap on the total annual interest rate is also associated with an increase in the posted monthly interest rate. However, we believe this relationship is the result of interest caps that are so high, they have little or no impact on funders. For example, in 2019, Nevada enacted legislation imposing a 40% annual interest rate cap. Our results suggest that such a high cap induces funders to *increase* the interest they charge, perhaps because a higher interest rate is now explicitly allowed or because it provides a new anchor to which the funder increases its existing rate.

The results in Table 4 suggest that funders attempt to circumvent restrictions on the funding agreement by altering other terms. In unreported estimations, we also find that restrictions on terms are associated with changes in non-interest-rate terms in the agreement. For example, we find that legislative restrictions on how long funders can charge interest are associated with funders switching from annual to monthly compounding, which increases the final amount that the consumer owes the funder.

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[62] Each cell reports the coefficient from the linear regression with its standard error in parentheses. ***, **, and * denote coefficients that are significant at the 99%, 95%, and 90% level, respectively.

Similarly, restrictions on how long the funder can charge interest and prohibitions on compounding are generally associated with funders increasing the length of the interest buckets, which increases the minimum interest that consumers will pay.

c. The Weighted Annualized Rate of Return to Funders

Next, we explore whether legislative or regulatory restrictions on terms in the funding agreement have an impact on the actual returns to the funder. We look at the annual return weighted by the amount funded, as we are interested in the rate of return per dollar funded, and not per funding agreement. If funders are successful at circumventing restrictions on one term by altering other terms, as our previous results suggest, then we may see no or very little change in their actual returns following restrictions.

To examine whether restrictions on the funding agreement have any effect on actual returns, we estimate the relationship between the weighted annualized rate of return and treatment variables that measure individual restrictions on the terms of the funding agreement. Table 5 reports the results, excluding the results of control variables for brevity.

Table 5: The Relationship between the Weighted Annualized Rate of Return and the Treatment Variables[63]

	Weighted Ratio of Funds Returned to Funder to the Amount Funded (Excluding NY)
Compounding frequency limited	0.118 (0.113)
Compounding prohibited	-0.066*** (0.023)
Limit on months interest charged	-0.056*** (0.016)
Cap on total annual interest	-0.043 (0.033)

The results indicate that limits on how long funders can charge interest and prohibitions on compounding have a negative and statistically significant relationship with the weighted annualized rate of return in most cases. The magnitudes of the coefficients indicate the percentage point decrease in annual returns associated with each restriction.

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[63] Notes: Each cell reports the coefficient from the linear regression with its standard error in parentheses. ***, **, and * denote coefficients that are significant at the 99%, 95%, and 90% level, respectively.

For example, a limit on how long funders can charge interest is associated with a 5.6 percentage points decrease in annual returns.

These restrictions reduce the returns to the funder despite the fact that the funder responds to the restrictions by increasing the posted interest rate. These results suggest that the funder's attempts to circumvent the restrictions are not completely successful; even though the funder increases the interest rate, it still experiences a reduction in the weighted annualized rate of return. Perhaps the increase in the interest rate is not enough to offset the effect of the other restrictions, or perhaps the funder encounters resistance at the point of trying to collect the higher interest and is forced to offer a discount. Either way, the restrictions are reducing the funder's returns, which explains why, as shown in Table 3, the funder often reduces its funding activity in response to these restrictions.

2. *Results for New York*

Next, we examine whether the 2005 voluntary agreement between a LTPF trade group and the state Attorney General in New York had similar impacts on funding activity and the terms in LTPF agreements.[64] The voluntary agreement in New York did not impose caps on the interest rate or restrictions on other terms the funding agreements. It only required the clear disclosure of certain terms: the total amount advanced to the consumer, the itemization of one-time fees, the percentage fee or rate of return stated on an annualized basis, and the total amount to be repaid by the consumer broken out in six-month intervals. [65]

Table 6 reports the results, excluding the results of control variables for brevity. In New York, the voluntary agreement between funders and the Attorney General increased funding activity by an average of almost 2197 newly funded cases each year. Compared to New York's average annual number of funded cases of 3186, this represents a 69 percent increase. Although there were no restrictions on LTPF prior to the agreement, the results suggest that the funder viewed the minor disclosure

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[64] The voluntary agreement was between the American Legal Finance Association (ALFA) and the State of New York. *See* Jenna Wims Hashway*, Litigation Loansharks: A History of Litigation Lending and a Proposal to Bring Litigation Advances Within the Protection of Usury Laws*, 17 ROGER WILLIAMS U. L. REV. 750, 775- 77 (2012) (citations omitted):

> ALFA trumpeted the agreement as "the first agreement of its kind in the nation" and vowed "[t]o establish and maintain the highest ethical standards and fair business practices within the legal funding industry." . . . An advertisement on the ALFA website encourages attorneys to look for the ALFA logo . . . . The ad urges lawyers to "[o]nly trust an ALFA member company" because "member companies adhere to best practices for the industry according to guidelines created with the New York Attorney General."

[65] See Attorney Gen. of N.Y., Bureau of Consumer Frauds & Prot., *Assurance of Discontinuance Pursuant to Executive Law § 63(15)* (Feb. 17, 2005).

requirements under the agreement as much more favorable than the uncertainty about how LTPF might be regulated before the agreement was reached.

Table 6: The Relationship between Funding Activity and the Treatment Variables in New York[66]

	Number of Annual Funded Agreements (NY only)	Posted Monthly Interest Rate (NY only)	Minimum Interest Period (NY only)	Weighted Ratio of Funds Returned to Funder to the Amount Funded (NY only)
Adoption of voluntary agreement on LTPF	2196.61*** (819.9)	-0.143*** (0.001)	1.851*** (0.004)	-0.209*** (0.057)

Although the voluntary agreement between funders and the Attorney General only required clear disclosure of certain terms in LTPF agreements, it nevertheless impacted the levels of some terms. According to the results, the funder lowered the posted monthly interest rate in LTPF agreements by an average of 0.143 percentage points. With an average monthly interest rate of 2.87 percent in New York LTPF agreements, this represents approximately a 5 percent decrease. Why did the funder lower the posted monthly interest rate when the voluntary agreement did not require that? First, the funder may have lowered rates for the same reason it presumably increased funding activity by 69 percent—because the voluntary agreement largely eliminated the regulatory risk of providing LTPF funding. This may have changed the economic perspective of the funder going forward in a number of ways. First, the funder was willing to accept a lower rate from its standard client base once funding became less risky. Second, since less risky funding would be expected to attract new entrants into the market, the funder may have anticipated or experienced competitive pressure to lower rates. Third, if the funder could rely on the market remaining stable, it could take on more debt and expand its client base by investing in more advertising or lowering its underwriting standards. Finally, the voluntary agreement's requirement that funders clearly state the interest rate on an annualized basis invited more scrutiny of higher rates, which may also have motivated the funder to lower rates.

The voluntary agreement also prompted the funder to increase the minimum interest period, or the number of months of interest the consumer has to pay even if the

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[66] Notes: Each cell reports the coefficient from the linear regression with its standard error in parentheses. ***, **, and * denote coefficients that are significant at the 99%, 95%, and 90% level, respectively.

case settles immediately, which is a type of an early exit penalty.[67] Our results indicate that the funder increased the minimum interest period by over 1.8 months in response to the funding agreement. With a median minimum interest rate period of approximately 3 months, this represents over a 50 percent increase. The voluntary agreement also was associated with a 20.9 percentage point decrease in the funder's weighted average rate of return. Taken together, these results suggest that the funder was not able to entirely offset the voluntary reduction in the posted interest rate by increasing the minimum interest period—annual returns still decreased.

The funder's response to the voluntary agreement—its lowering of the interest rate and its increase in funding activity despite lower returns—suggests that legislation or agreements that take some of the uncertainty out of funding ultimately benefit consumers. The funder was willing to accept a lower interest rate and lower returns either because new entrants put competitive pressure on the funder or because the funder didn't demand the same return for less risky funding. Regardless, the clarity provided by the voluntary agreement about how funding would be regulated benefited consumers by lowering their cost of LTPF.

V. CONCLUSION

Increasingly, policymakers and scholars are calling for regulation of the LTPF industry to protect vulnerable consumers from predatory funding. In many states, courts have imposed judicial restrictions and legislatures have enacted laws regulating the industry. However, no prior work has analyzed whether regulation of the LTPF industry has actually impacted funders' behavior or consumers' welfare.

Using a unique private dataset from one of the largest consumer litigation financing firms and data collected from court decisions and state legislation, we examine whether regulation of the LTPF industry has been effective. Our analysis reveals that restrictive court rulings and regulations generally induce funders to either leave the jurisdiction or to make adjustments to other terms in the funding agreement in an effort to maintain their returns. Although the funder is not always successful in circumventing regulation, our results suggest that many current regulations and restrictions on LTPF may not be producing the intended effect.

Policymakers should understand how funders try to evade the spirt of regulation by adjusting non-regulated terms in their funding agreements or avoid a regulation all together by shifting their business to another jurisdiction. Only by closing these loopholes will courts and lawmakers be able to protect consumers. For example, rather than restricting specific terms in a LTPF agreement, a law requiring that plaintiffs in personal injury cases receive some minimum return would prevent funders from circumventing restrictions by

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[67] This is consistent with the funder expanding its client base since it may be the case that post-reform clients allowed the funder to underwrite more cases that were likely to settle very fast, which would tempt the funder to optimize this sort of profit.

adjusting other terms.[68] Similarly, national legislation protecting consumer plaintiffs would prevent funders from relocating to another state to take advantage of more lax LTPF regulations. But chances of both examples happening anytime soon are very slim.

Moreover, policymakers can learn something from the funder's response to the voluntary agreement in New York. Although the agreement did not require funders to lower the interest rate charged for funding, our funder did so, and it also accepted lower returns while increasing funding activity. Our results suggest that legislation or agreements that reduce the regulatory uncertainty of funding lead to more available and cheaper LTPF for consumers.

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[68] Maya Steinitz, Written testimony on "Unsuitable Litigation: Oversight of Third-Party Litigation Funding" before the Committee on Oversight and Accountability United State House of Representatives, September 13, 2013, available at https://oversight.house.gov/wp-content/uploads/2023/09/MSteinitz_Testimony-Before-the-House-of-Representatives-Sept.-11-2023.pdf.

Appendix 1:

Status of LTPF in each State; 2020

State	LTPF prohibited	No laws/decisions; LTPF is presumably allowed	LTPF allowed; no regulation	LTPF allowed; regulation is lenient	LTPF allowed; regulation is prohibitive
Alabama	yes				
Alaska		yes			
Arizona	yes				
Arkansas					yes
California			yes		
Colorado					yes
Connecticut			yes		
Delaware			yes		
Florida			yes		
Georgia			yes		
Hawaii		yes			
Idaho		yes			
Illinois			yes		
Indiana				yes	
Iowa		yes			
Kansas	yes				
Kentucky	yes				
Louisiana		yes			
Maine				yes	
Maryland					yes
Massachusetts			yes		
Michigan			yes		
Minnesota			yes		
Mississippi	yes				
Missouri	yes[69]				
Montana			yes		
Nebraska				yes	
Nevada				yes	
New Hampshire			yes		
New Jersey			yes		
New Mexico		yes			
New York				yes	

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[69] In 2023, Missouri enacted legislation allowing LTPF with regulation.

North Carolina					yes
North Dakota		yes			
Ohio				yes	
Oklahoma				yes	
Oregon		yes			
Pennsylvania			yes		
Rhode Island		yes			
South Carolina			yes		
South Dakota		yes			
Tennessee				yes	
Texas		yes			
Utah				yes	
Vermont				yes	
Virginia		yes			
Washington		yes			
West Virginia					yes
Wisconsin				yes	
Wyoming		yes			

Appendix 2:

States' Regulation of Specific Terms of LTPF Funding Agreements; 2020

State	Total Fee Cap (% per annum)	Compounding Prohibited	MaxCompound Frequency (max per year)	Maximum Months Interest can be Charged
Alabama				
Alaska				
Arizona				
Arkansas	17	yes		
California				
Colorado	21[70]	yes		
Connecticut				
Delaware				
Florida				
Georgia				
Hawaii				
Idaho				
Illinois				
Indiana	43	yes		
Iowa				
Kansas	21[71]		1	
Kentucky				
Louisiana				
Maine			2	42
Maryland	24	yes		72.5
Massachusetts				
Michigan				
Minnesota				
Mississippi				
Missouri				
Montana				
Nebraska			2	36
Nevada	40			
New Hampshire				
New Jersey				

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[70] We collapsed different interest rates at different loan amounts into an average rate of 21 percent.
[71] The interest rate of 21 percent applies for unlicensed lenders.

New Mexico				
New York				
North Carolina	16	yes		
North Dakota				
Ohio				
Oklahoma				
Oregon				
Pennsylvania				
Rhode Island				
South Carolina	12[72]			
South Dakota				
Tennessee	46	yes		36
Texas				
Utah				
Vermont				
Virginia				
Washington				
West Virginia	18	yes	2	42
Wisconsin				
Wyoming				

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[72] The interest rate of 12 percent applies to unlicensed lenders.

Appendix 3:

Full Results for Table 3: The Relationship between Funding Activity and the Treatment Variables[73]

	Number of Funded Agreements (Excluding NY)				
No laws or decisions pertaining to LTPF	49.995** (24.258)				
LTPF is allowed & leniently regulated	-0.226 (15.014)				
LTPF is allowed and not regulated	30.634 (25.904)				
Compounding frequency limited		-32.723* (18.454)			
Compounding prohibited			-54.744* (29.80)		
Limit on # of months interest charged				-20.422 (19.364)	
Cap on total annual interest					-51.698** (23.372)
Proportion Female in State	20.68 (14.93)	25.20 (16.87)	21.38 (15.28)	24.56 (16.38)	20.13 (15.01)
Average Plaintiff Age in State	-3.62 (2.81)	-3.55 (2.81)	-3.06 (2.67)	-3.24 (2.67)	-3.49 (2.78)
Average Plaintiff Age squared in State	.035 (.032)	.034 (.033)	.030 (.031)	.030 (.031)	.034 (.032)
Casetype proportion variables	yes	yes	yes	yes	yes
State fixed effects	yes	yes	yes	yes	yes
Year fixed effects	yes	yes	yes	yes	yes
number of observations	698	698	698	698	698
R-squared	.7402	.7375	.7390	.7372	.7397

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[73] In all tables, each cell reports the coefficient from the linear regression with its standard error in parentheses. ***, **, and * denote coefficients that are significant at the 99%, 95%, and 90% level, respectively.

Full Results for Table 4: The Relationship between the Posted Interest Rate and the Treatment Variables

	Posted Monthly Interest Rate (Excluding NY)			
Compounding frequency limited	.00094 (.03990)			
Compounding prohibited		0.2568*** (.0709)		
Limit on # of months interest charged			0.1547*** (0.0424)	
Cap on total annual interest				.2051*** (.06411)
Female Plaintiff indicator	-.0062 (.0076)	-.0060 (.0077)	-.0061 (.0077)	-.0057 (.0077)
Plaintiff Age	.0031*** (.0011)	.0031*** (.0011)	.0031*** (.0011)	.0031*** (.0011)
Plaintiff Age squared	-.0004*** (.0001)	-.0004*** (.0001)	-.0004*** (.0001)	-.0004*** (.0001)
Casetype fixed effects	yes	yes	yes	yes
State fixed effects	yes	yes	yes	yes
Year fixed effects	yes	yes	yes	yes
number of observations	50,514	50,514	50,514	50,514
R-squared	.3482	.3503	0.3488	.3499

Full Results for Table 5: The Relationship between the Weighted Annualized Rate of Return and the Treatment Variables

	Weighted Ratio of Funds Returned to Funder to the Amount Funded (Excluding NY)			
Compounding frequency limited	0.118 (.113)			
Compounding prohibited		-.066*** (.023)		
Limit on # of months interest charged			-.056*** (.016)	
Cap on total annual interest				-.043 (.033)
Female Plaintiff indicator	-.00055 (.0018)	-.00065 (.0018)	-.00065 (.0018)	-.00069 (.0018)
Plaintiff Age	.0009 (.0006)	.0009 (.0006)	.0009 (.0006)	.0009 (.0006)
Plaintiff Age squared	-.00001 (.00007)	-.00001 (.00007)	-.00001 (.00007)	-.00001 (.00007)
Casetype fixed effects	yes	yes	yes	yes
State fixed effects	yes	yes	yes	yes
Year fixed effects	yes	yes	yes	yes
number of observations	36,709	36,709	36,709	36,709
R-squared	0.3007	0.3011	0.3006	0.3006

Full Results for Table 6: The Relationship between Funding Activity and the Treatment Variables in New York

	Number of Annual Funded Agreements	Posted Monthly Interest Rate	Minimum Interest Period	Weighted Ratio of Funds Returned to Funder to the Amount Funded
Adoption of voluntary agreement on LTPF	2196.61*** (819.9)	-.1435*** (.001)	1.851*** (.004)	-0.209*** (0.057)
Female Plaintiff proportion or indicator	-10883.2 (13330.7)	-.0168* (.0088)	.0379* (.0214)	-.590 (.921)
Plaintiff Age variable	-5693.5*** (2189.2)	.0024 (.0021)	.0172*** (.0032)	.6626*** (.172)
Plaintiff Age variable	75.32** (29.29)	-.00002 (.00002)	-.0001*** (.00004)	-.0085*** (.0023)
Casetype proportion or fixed effects	yes	yes	yes	yes
State fixed effects	yes	yes	yes	yes
Year fixed effects	yes	yes	yes	yes
number of observations	19	47,533	47,533	19
R-squared	0.9046	0.2816	0.2627	0.8542

United States Government Accountability Office

Report to Congressional Requesters

December 2022

THIRD-PARTY LITIGATION FINANCING

Market Characteristics, Data, and Trends

GAO-23-105210

GAO

Highlights

Highlights of GAO-23-105210, a report to congressional requesters

December 2022

THIRD-PARTY LITIGATION FINANCING

Market Characteristics, Data, and Trends

Why GAO Did This Study

Litigation funders are typically private firms that obtain investment capital from a variety of investors, such as endowments and pensions. While third-party litigation financing has been well established for decades in some countries, such as Australia and England, it gained a foothold in the U.S. around 2010, according to literature GAO reviewed. However, publicly available data on the market are limited. Some policymakers have raised concerns about the transparency of funding arrangements and other issues.

GAO was asked to review issues related to third-party litigation financing. This report describes (1) characteristics of and trends in the commercial and consumer markets, (2) data gaps in the markets, and policy options to address them, (3) potential advantages and disadvantages of third-party litigation financing for users and investors, and (4) its regulation and disclosure.

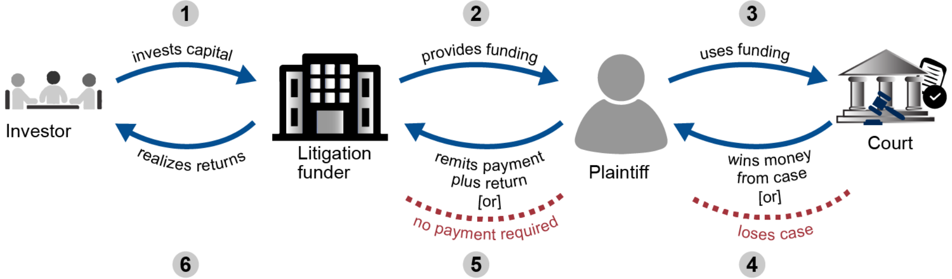
GAO analyzed data provided by a nongeneralizable sample of litigation funders for 2017–2021 (selected based on the category of funding they provide and other factors); reviewed relevant laws, court rules, and reports by academic researchers, government agencies, and others; interviewed federal agencies, litigation funders, and U.S. and international trade associations; and convened a roundtable with 12 experts (selected to represent a mix of views and professional fields, among other factors).

View GAO-23-105210. For more information, contact Michael E. Clements at (202) 512-8678 or clementsm@gao.gov.

What GAO Found

Third-party litigation financing is an arrangement where a funder that is not a party to a lawsuit agrees to provide funding to a litigant (typically a plaintiff) or law firm in exchange for an interest in the potential recovery in a lawsuit (see figure). Plaintiffs do not have to repay the funding if their lawsuit is not successful. This funding generally falls into two categories: commercial and consumer funding. Commercial arrangements are between funders and corporate litigants or law firms. For example, a funder agrees to provide funding for legal or business expenses in exchange for a portion of the court award if the plaintiff wins. The funding is typically in the millions of dollars. Consumer arrangements are between a funder and an individual, such as the plaintiff in a personal injury case. The funder provides a relatively small amount (typically under $10,000) to the plaintiff, who uses it for living expenses. Trends identified by funders GAO interviewed included increased acceptance or familiarity with commercial and consumer funding arrangements and growth in the commercial market.

Example of Third-Party Litigation Financing for Plaintiffs



Source: GAO. | GAO-23-105210

Experts GAO spoke with identified gaps in the availability of market data on third-party litigation financing, such as funders' rates of return and the total amount of funding provided. They identified policy options to address the gaps and challenges posed by them. For example, state or federal courts could collect data, but the data may be incomplete or could create more burden for the courts.

Funders and stakeholders GAO interviewed identified several advantages and disadvantages of third-party litigation financing for users and investors. For example, this funding can help underfunded plaintiffs litigate their cases. However, it is expensive and may deter plaintiffs from accepting a settlement offer because they may want to make up the amount they will repay the funder. Third-party litigation financing can offer investors potentially high returns. But, the investor risks losing the investment if the plaintiff loses the case.

The third-party litigation financing industry is not specifically regulated under U.S. federal law. However, some states regulate consumer funding by, for example, limiting the fees funders can charge. There also is no nationwide requirement to disclose litigation funding agreements to courts or opposing parties in federal litigation, although courts have required disclosures of funding arrangements in some instances.

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Abbreviations

CFPB	Consumer Financial Protection Bureau
Exchange Act	Securities Exchange Act of 1934
SEC	Securities and Exchange Commission
TPLF	third-party litigation financing

GAO U.S. GOVERNMENT ACCOUNTABILITY OFFICE
441 G St. N.W.
Washington, DC 20548

December 20, 2022

The Honorable Chuck Grassley
Ranking Member
Committee on the Judiciary
United States Senate

The Honorable Andy Barr
Ranking Member
Subcommittee on National Security, International Development and Monetary Policy
Committee on Financial Services
House of Representatives

The Honorable Darrell Issa
Ranking Member
Subcommittee on Courts, Intellectual Property, and the Internet
Committee on the Judiciary
House of Representatives

Third-party litigation financing (TPLF), also referred to as litigation funding or alternative litigation financing, is an arrangement in which a funder that is not a party to a lawsuit agrees to provide nonrecourse funding to a litigant or law firm in exchange for an interest in the potential recovery in a lawsuit.[1] The nonrecourse nature of TPLF means that if the lawsuit is not successful, the litigant or law firm does not have to repay the funding.[2]

In the U.S., TPLF arrangements are available for both commercial and consumer claims. Plaintiffs and defendants may litigate these claims in U.S. federal or state courts. Nonrecourse funding may also be used in

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[1] We do not include other types of third-party funding for disputes, such as loans from banks, within the scope of this report.

[2] According to a report we reviewed, the nonrecourse nature of TPLF distinguishes it from traditional loans, which require repayment of the principal and interest, regardless of the outcome in a case. New York City Bar, *Report to the President by the New York City Bar Association Working Group on Litigation Funding* (New York, NY: Feb. 2020), 4. While TPLF arrangements are typically nonrecourse, recourse arrangements also exist, according to literature we reviewed. *See*, *e.g.*, Sean Thompson, Dai Wai Chin Feman, and Aaron Katz, "United States," in *The Third Party Litigation Funding Law Review*, 3rd ed., ed. Leslie Perrin (London, UK: Law Business Research, Dec. 2019), 225.

claims that are arbitrated (a method of resolving a legal dispute without a trial) in the U.S. or internationally.[3]

TPLF has been well established for decades in other countries. While TPLF gained a foothold in the U.S. around 2010, publicly available data on litigation funders and TPLF arrangements remain limited. Additionally, some policymakers have raised concerns about the transparency of these arrangements and the high fees litigation funders charge their clients.

You asked us to review several issues related to TPLF. This report describes (1) characteristics of and trends in the commercial and consumer TPLF markets, (2) data gaps in the markets, and policy options to address them, (3) potential advantages and disadvantages of TPLF for users and investors, and (4) regulation and disclosure of TPLF in the U.S. and selected foreign countries.

Publicly available data on the TPLF market are limited as there is no central repository of information on funders and no federal law expressly requires all litigation funders to report market data publicly. Accordingly, to address the first objective, we reviewed annual financial reports from the two publicly traded commercial litigation funders we identified and collected data on TPLF transactions for 2017–2021. We sent a data collection instrument to all 12 funders we interviewed (selected by the methods described below) and received data from four of them.[4] We assessed the reliability of the data we collected by reviewing the data for obvious errors and obtaining written responses from the funders on the systems and methods they used to produce the data. We determined that the data we included in the report were sufficiently reliable for purposes of describing TPLF transactions from selected funders for 2017–2021. Data we collected cannot be generalized to all litigation funders.

We also reviewed reports by academic researchers, government agencies, and others that we identified through a literature search.

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[3] In arbitration, a neutral decision maker (an arbitrator) issues a judgment in a case after listening to presentations by each party.

[4] We also requested examples of litigation funding agreements from the 12 funders we interviewed. Some funders declined the request for legal reasons (for example, one said disclosing its agreements could put related privileges and protections at risk and potentially harm the underlying litigation). Six funders provided examples of their agreements but omitted or redacted relevant data, such as investment returns, fees, and funding amounts.

Additionally, we interviewed officials from four federal agencies: the Securities and Exchange Commission, Consumer Financial Protection Bureau, Department of Justice, and Federal Judicial Center. We also conducted semistructured interviews with a sample of 12 litigation funders operating in the U.S. (seven commercial and five consumer funders) and 10 industry stakeholders.[5] We judgmentally selected the funders to include a mix in the type of TPLF provided, and we selected the stakeholders for their knowledge of the U.S. TPLF market, among other factors.[6] Information gathered from these interviews cannot be generalized to all litigation funders or industry stakeholders.

For the second objective, we convened a virtual roundtable of 12 experts to discuss policy options for addressing data gaps in the U.S. TPLF markets. We selected the experts based on their published work on TPLF and their knowledge about the industry, among other factors. We also discussed the data gaps and options identified by the experts with three litigation funding associations.

For the third objective, we reviewed reports by academic researchers, government agencies, and others that we identified through a literature search. We also interviewed litigation funders and industry stakeholders, selected through the methods described earlier.

For the fourth objective, we interviewed the federal agencies and industry stakeholders described above and reviewed legal materials related to TPLF in the U.S., including federal and state laws, federal court rules, proposed legislation, proposals by industry stakeholders to amend federal court rules, and reports by legal practitioners, government agencies, and others identified through a literature search.[7] We also selected three other countries (Australia, England, and Canada) and reviewed regulation and disclosure of TPLF. We selected the countries because they include a mix of geographic locations and have legal systems similar in some

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[5] Industry stakeholders included trade associations, academic researchers, and other groups or individuals who had experience in or knowledge about consumer or commercial TPLF.

[6] The total number of litigation funders operating in the U.S. is unknown because of limited data.

[7] We did not conduct a comprehensive survey of state law on TPLF. Also, the fourth objective focuses on regulation and disclosure of TPLF in the context of litigation rather than arbitration.

respects to that of the U.S., among other factors.[8] We reviewed literature related to TPLF in these countries and interviewed government representatives from the Australian Treasury. We also interviewed industry stakeholders from the U.S. and each other country. Information gathered from these interviews cannot be generalized to all industry stakeholders. See appendix I for more details on our scope and methodology.

We conducted this performance audit from April 2021 to December 2022 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Overview of Third-Party Litigation Financing

TPLF has become a more established market in the U.S. in the past decade. It had been limited to some degree by prohibitions against maintenance, champerty, and barratry, which are common law doctrines that were incorporated into the laws of many states at the time of the nation's founding.[9] Maintenance refers to helping another prosecute a suit; champerty is maintaining a suit in return for a financial interest in the outcome; and barratry is a continuing practice of maintenance or champerty.[10] However, many states have begun to relax these prohibitions, according to literature we reviewed, which may have contributed to TPLF's increased acceptance and recent growth.[11]

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[8] According to literature we reviewed, the legal systems of the United States, Australia, England and Canada incorporate common law principles. *See, e.g.*, Nicholas G. Karambelas, "Limited Liability Companies: Law, Practice and Forms," (2021).

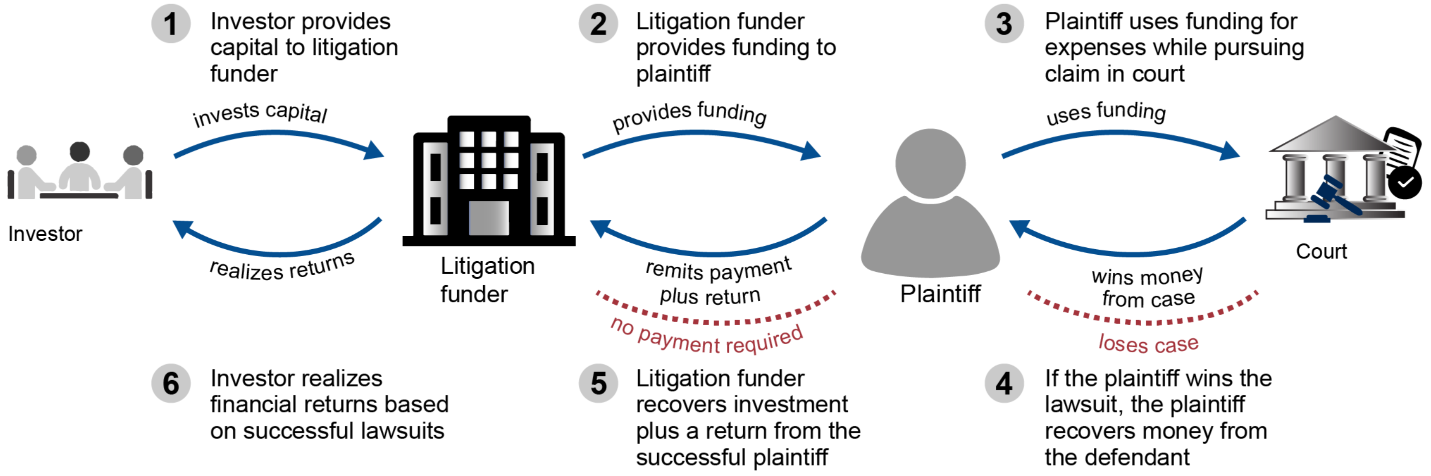
[9] Thompson, Feman, and Katz, "United States," in *The Third Party Litigation Funding Law Review*, ed. Perrin, 219. The TPLF market has been well established for decades in countries such as Australia and England, where changes to champerty and maintenance laws, along with other factors, may have contributed to its growth.

[10] *In re Primus*, 436 U.S. 412, 424 (1978).

[11] New York City Bar, *Report to the President*, 7. According to the report, 28 jurisdictions permit maintenance (with limitations) and 16 explicitly allow champerty.

TPLF generally falls into two categories: commercial and consumer funding. Commercial TPLF arrangements are typically between a litigation funder and a corporate plaintiff or law firm and involve commercial claims, such as breach of contract. Consumer TPLF arrangements are between a funder and an individual person, such as the plaintiff in a personal injury case. Experts we spoke with noted that there could be other categories of TPLF. For example, TPLF for consumer class actions and mass tort litigation could be considered a separate category of TPLF altogether.[12] Plaintiffs that win their cases will generally repay the funder the amount funded plus a return on their investment as outlined in the TPLF agreement.[13] Plaintiffs do not have to repay the funding if they lose the case (see fig. 1).

Figure 1: Example of Third-Party Litigation Financing for Plaintiffs



Source: GAO. | GAO-23-105210

Note: Litigation funders are typically private firms that obtain investment capital from a variety of investors, such as endowments and pensions.

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[12] Black's Law Dictionary defines a class action as "a lawsuit in which the court authorizes a single person or a small group of people to represent the interests of a larger group." *Black's Law Dictionary*, 11th ed. (2019). The dictionary defines a mass tort as "a civil wrong that injures many people [such as] toxic emissions from a factory [or] the crash of a commercial airliner."

[13] Return structures can vary. Examples include returns based on a multiple of what a funder invested, a pre-negotiated percentage of the recovery, or a percentage rate of return.

Litigation funders vary in type, size, and investor base. For example, many funders are private entities that specialize in TPLF.[14] They may obtain investment capital from institutional investors, such as endowments and pensions, according to funders we interviewed. Other firms may be multistrategy funders, which are firms that invest in various markets and asset classes. A small number of funders are large, publicly traded companies. Other funders are smaller firms that may be backed by single investors, such as high-net-worth individuals, or may be family offices or hedge funds that only occasionally participate in litigation funding, according to literature we reviewed and a funder we interviewed.[15]

Litigation funders and other TPLF market participants have formed trade associations that support various policy positions on TPLF. For example, the International Legal Finance Association consists of 15 commercial litigation funders and was founded to represent the global commercial legal finance community. The association's mission is to engage with legislative, regulatory, and judicial authorities about commercial TPLF. The American Legal Finance Association consists of over 30 consumer litigation funders operating in the U.S.[16] The association supports legislation that regulates the consumer TPLF market. The Institute for Legal Reform, which is part of the U.S. Chamber of Commerce (a business trade association), has published reports on TPLF and developed proposals to mandate the disclosure of TPLF arrangements in any civil action filed in federal court.

Civil Litigation Process

A civil lawsuit may be filed in federal court or state court, depending on the type of claim. The specific procedures used in state courts vary,

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[14] Westfleet Advisors, *The Westfleet Insider: 2021 Litigation Finance Market Report* (2022).

[15] Westfleet Advisors, *The Westfleet Insider*.

[16] App. II lists the members of the International Legal Finance Association and American Legal Finance Association.

although many states have modeled their procedural rules on those used in federal courts.[17]

A civil lawsuit in federal court begins when a plaintiff files a complaint with the court and provides a copy of the complaint to the defendant.[18] The complaint describes the plaintiff's damages or injury, explains how the defendant caused them harm, shows that the court has jurisdiction, and asks the court for relief, such as money to compensate for the plaintiff's injury.

To prepare for trial, the parties must conduct discovery, a process in which they provide information to each other about the case, such as copies of any case-related documents. They also may file motions (requests with the court) asking the court to make decisions about the discovery process or about the procedures that will be followed at trial.

To limit the costs and delays that typically come with a trial, judges encourage litigants to try to reach an agreement resolving their dispute (known as a settlement) before going to trial. If a case is not settled, the court will schedule a trial, where a judge or jury will decide the case.

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[17] There are federal rules of evidence and procedural rules that must be followed in cases brought in federal courts. The Chief Justice of the U.S. Supreme Court appoints committees of judges, lawyers, and professors to draft the rules. The rules are published for public comment and are later approved by the Judicial Conference of the United States, which is the national policy-making body for federal courts. The rules are promulgated by the U.S. Supreme Court and become law unless Congress votes to reject or modify them. Administrative Office of the U.S. Courts, *Understanding the Federal Courts*, 10. For a discussion of procedural rules in state courts, see John B. Oakley, "A Fresh Look at the Federal Rules in State Courts," 3 Nev. L.J. 354 (Winter 2002/2003).

[18] The following discussion of the civil litigation process in federal courts is based on the Administrative Office of the U.S. Courts' *Understanding the Federal Courts,* 11.

Commercial and Consumer TPLF Differ in Clients and Uses of Funding, and the Commercial Market Has Grown in Recent Years

Commercial TPLF Is Used by Law Firms and Companies to Fund Legal and Other Expenses

Corporate plaintiffs and law firms typically use commercial TPLF to fund legal expenses or to supplement their general operating budgets, according to seven funders and one trade association we interviewed.[19] The funders said their clients can include both small and large companies and law firms of varying sizes.

Commercial litigation funders we interviewed typically provided users with millions of dollars through single-case or portfolio financing agreements. The types of claims funded by commercial TPLF varied, as did the types of investors in the market.

- **Types of funding arrangements.** Single-case and portfolio arrangements are the most common financing arrangements identified by the seven commercial funders we interviewed. Single-case agreements are typically made between a funder and a corporate plaintiff who exchanges a portion of the value of an individual case for funding. In contrast to single-case arrangements with a plaintiff, two commercial funders we spoke to said it was difficult to provide funding arrangements for defendants because of the way agreements are structured. For example, two funders said defense-side matters do not typically yield a financial recovery for the defendant, making it difficult for funders to recoup their investment in those cases. However, two funders said they could provide single-case financing to defendants with strong counterclaims against a plaintiff, which could provide the defendant with a recovery and a financial return to the funder.

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[19] The funding is provided in exchange for a portion of the value of a pending legal claim.

Portfolio arrangements involve a law firm or corporation using a portion of the value of a group of cases in exchange for funding.[20] Clients generally have more flexibility in their use of portfolio funding compared with single-case funding. For example, in addition to using funding for legal costs, a company can use portfolio funding to expand its business while its operating budgets are tied up in litigation, according to one trade association. Three funders and one trade association also told us that law firms may include both plaintiff and defense-side matters in a portfolio arrangement, allowing them to finance defense-side matters that would typically be difficult to fund through single-case arrangements.[21]

- **Types of claims.** The seven commercial litigation funders we interviewed told us they offered funding for various types of claims, including intellectual property, antitrust, asset recovery, fraud, and class actions. Five of the seven funders said they offered financing arrangements both in the U.S. and abroad, including in Australia and Europe. Some funders said they selected where to do business based on factors such as whether the region had an existing TPLF market and a legal system favorable to TPLF.[22]

- **Funding amounts.** Commercial TPLF funders typically provide millions of dollars in funding for high-value litigation and arbitration. For example, one trade association estimated its members (commercial funders) invested in litigation with damages worth $10 million or more, and typically invested a minimum of $2 million per

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[20] Data we collected from three commercial funders show that of their 92 total new portfolio agreements made between 2017 and 2021, 80 were made with law firms, and 8 were made with other companies. The remaining 4 agreements were for mixed portfolios that may have included law firms or other companies.

[21] Two commercial litigation funders and one trade association we spoke with said funders may offer other types of financing arrangements based on client needs. For example, they may offer post-settlement financing, in which funders advance money to a law firm based on the firm’s outstanding client receivables (unpaid fees that a client owes the law firm). Other examples include corporate claim monetization, which allows companies to get funding based on the value of pending commercial claims, and judgment enforcement, which allows a company to sell the rights to an awarded judgment to a funder, offsetting the need for the company to spend its own time and resources to enforce the judgment.

[22] In 2020, two publicly traded commercial litigation funders operating in the U.S. reported that the largest portion of their capital was concentrated in North America. Burford Capital reported that 43 percent of its capital was concentrated in North America and Omni Bridgeway reported that 49 percent of its estimated portfolio value was concentrated in North America.

transaction. Additionally, three commercial litigation funders we collected data from deployed, on average, about $2.3 million per single-case agreement and $4.5 million per portfolio agreement over the last 5 years. Similarly, a TPLF market report found that, in 2021, the average value of new single-case arrangements for the commercial funders that provided data was $3.5 million and the average value of portfolio arrangements was $8.5 million.[23]

- **Investors.** In the commercial TPLF market, one funder is publicly traded in the U.S. and the United Kingdom, and one funder is publicly traded in Australia. Funders told us their investors were typically large, sophisticated private entities, such as endowments and pensions. Investors for two funders also included sovereign wealth funds, which are government-controlled funds that seek to invest in other countries, and for another funder, family offices, which are offices that manage the investments of wealthy families.[24]

All the commercial funders we spoke with said that before deciding whether to fund a client, they undertook a due diligence process that evaluated several factors. Funders most commonly said they considered the merits of a potential case (six of seven funders), the potential client's legal team (five of seven funders), and the ability of the defending party to pay (five of seven funders). Most funders said they only fund a small percentage of the total requests for funding they receive after conducting due diligence. For example, data from two funders show that about 5 percent of formal requests for funding ultimately resulted in a funding agreement. Similarly, Burford Capital reported that in 2020 only 4 percent of requests for funding resulted in financing agreements.[25] Funders select the most meritorious cases to fund because they only receive returns when claims are successful.

All of the commercial litigation funders we interviewed said they did not make any decisions about litigation strategy for the cases they fund through TPLF arrangements. For example, three funders said they did not

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[23] Westfleet Advisors, *The Westfleet Insider*. Westfleet Advisors collected anonymized data from commercial funders with a U.S. nexus for the period of July 1, 2020, to June 30, 2021. Westfleet reported that most of the 47 funders they identified with substantial market participation chose to provide data.

[24] One funder did not provide details about its sovereign wealth fund investor. The other, Burford Capital, publicly reported that at December 31, 2021, two funds with a sovereign wealth fund investor represented approximately 28 percent of its $2.8 billion in assets under management. Burford Capital, *Burford Capital Annual Report 2021* (2022).

[25] Burford Capital, *Burford Capital Annual Report 2020* (2021).

have the authority to decide whether to settle or move forward with a case. Some funders indicated they provided their views on elements of a case if requested by a client.

The Commercial TPLF Market Has Grown in Recent Years as Businesses Have Become More Familiar with It

Data collected from three commercial funders show they experienced growth between 2017 and 2021. Additionally, funders and stakeholders we spoke with said industry growth is a trend they observed in the U.S. commercial TPLF market at large over the last 5 years. They also told us there have been some changes in the commercial TPLF client base and the type of agreements funders offered.

- **Industry growth.** Data we collected from three commercial funders show that they experienced growth between 2017 and 2021. For example, the amount of TPLF the funders provided to clients through single-case and portfolio arrangements more than doubled. Additionally, formal requests for funding agreements increased by 27 percent, while total new agreements increased by 19 percent. All seven of the commercial litigation funders and one trade association we interviewed also told us the industry has grown in recent years. Some funders attributed this growth to larger corporations or law firms becoming more familiar with TPLF and more comfortable using it. They said they have observed growth in the number of funders entering the market, the amount of funding provided, the number of cases funded, investor interest, and demand for TPLF.

  A 2021 market report also found that, among the funders that provided data, commercial TPLF had experienced growth in the last year in terms of capital from investors and new commitments toward litigation finance deals.[26] For example, capital commitments toward new deals increased 11 percent compared to the prior year, according to the report.[27] Further, the report provided the best available estimates we identified of the size of the U.S. commercial TPLF market. Specifically, it identified 47 active commercial litigation funders, and reported that they had a total of $12.4 billion in assets

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[26] Westfleet Advisors, *The Westfleet Insider*. Westfleet reported that most of the 47 funders they identified with substantial market participation chose to provide data.

[27] In the report, Westfleet Advisors stated that it remains cautious about drawing sweeping conclusions on the trajectory of the market given the irregularities present in the U.S. litigation system and the broader economy, but noted that its 2021 report represents the third year for which it has collected and analyzed industry data, and its views are informed by those statistics. Westfleet Advisors, *The Westfleet Insider*.

under management and had committed $2.8 billion to new litigation financing agreements in 2021.[28]

However, no comprehensive estimate of total market size exists because publicly available data on the market are limited: there is no central repository of information on litigation funders, and no federal law expressly requires all litigation funders to report market data publicly.[29] In addition, industry observers and participants do not always agree on what should be measured.

- **Increased acceptance and use of TPLF.** All the commercial funders we interviewed said there had been an increased acceptance of litigation financing in recent years. Funders said increased acceptance had resulted in the use of TPLF by new parties, such as law firms and corporations and, according to one funder, an appetite for new and innovative funding agreement structures. For example, data we collected from three funders showed a shift from single-case agreements towards portfolio financing over the last 5 years. Specifically, portfolio agreements comprised about 39 percent of all new agreements in 2021, compared to about 19 percent in 2017. In addition, the proportion of total capital provided through portfolio agreements grew from 28 percent ($28 million of $101 million) in 2017 to 51 percent ($124 million of $240 million) in 2021. Similarly, Westfleet Advisors reported that in 2021, 59 percent of new capital commitments for the funders that provided data went to portfolio agreements.[30]

Consumer TPLF Is Commonly Used by Plaintiffs with Personal Injury Cases for Living Expenses

Four of the five consumer funders and two trade associations we spoke with said consumer TPLF clients used funding to pay for living expenses (e.g., rent and medical bills) while their litigation was ongoing. They did not use the funding to finance the litigation itself. One trade association

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[28] Westfleet Advisors, *The Westfleet Insider*.

[29] As discussed later, some litigation funders may be subject to public reporting requirements under federal securities laws and related rules and regulations.

[30] Westfleet Advisors, *The Westfleet Insider*. Westfleet reported that most of the 47 funders they identified with substantial market participation chose to provide data.

noted that using TPLF to pay legal costs could conflict with some states' champerty and maintenance laws.[31]

- **Types of funding arrangements.** All of the funders identified single-case funding arrangements for individual plaintiffs as their primary funding option.[32] Two funders said it was common to fund a client multiple times over the course of one case. The consumer litigation funders also told us they typically do not fund defendants. Defendants typically already have financial backing for litigation from their insurance policies, according to some funders.
- **Types of claims.** The five consumer funders, two trade associations, and one stakeholder we spoke with said consumer TPLF is provided to plaintiffs with personal injury cases. These cases included car accidents, slip-and-fall accidents, and medical malpractice.[33] Four of the funders said they offered funding in multiple states, depending on regulatory environment, but did not provide any international funding.
- **Funding amounts.** Two consumer litigation funders and two trade associations told us that consumer funders provide relatively small amounts of financing. They cited average funding amounts that ranged between $1,000 and $10,000. One study we reviewed found funders provided roughly 7 percent of the estimated value of a case in funding.[34] Two funders said they typically provided clients with no more than 10 percent of the estimated value of a case.[35] Four funders said they were conservative in the amount of funding they provide to clients to ensure they can recover their investment from future settlement awards. Three funders told us that if they provide too much

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[31] As discussed earlier in the report, maintenance refers to helping another prosecute a suit and champerty refers to maintaining a suit in return for a financial interest in the outcome.

[32] Three funders told us they occasionally provided financing to law firms, but this was rare and not their primary focus.

[33] One study of roughly 200,000 cases over a 10-year period found that about 59 percent of observed cases involved car accidents. Ronan Avraham and Anthony Sebok, "An Empirical Investigation of Third Party Consumer-Litigant Funding," *Cornell Law Review*, vol. 104, no. 5 (July 2019): 1133-1181. This study reviewed data from a single large consumer funder and its findings cannot be generalized to all consumer funders.

[34] Avraham and Sebok, "An Empirical Investigation of Third Party Consumer-Litigant Funding."

[35] For example, if a funder estimated a client's claim to be worth $100,000, it would provide that client no more than $10,000.

funding up front, it could deter clients from accepting settlement offers because of the amount they owe to the funder.

- **Investors.** The consumer funders we interviewed are private companies that receive their funding through a variety of investors. These include securitized offerings, private institutional investors, and private credit investors.

Consumer funders told us they evaluate certain factors before deciding whether to provide funding—for example, whether the defendant's liability for a plaintiff's injuries has been established and whether the defendant has insurance. Data we collected from one consumer funder showed that about 21 percent of requests resulted in first-time funding. Two other funders told us they funded roughly half the requests they received.

All five of the consumer litigation funders we spoke with said their agreements did not give them any control over a client's litigation. They also said they did not provide advice on litigation decisions, such as whether to move forward with a case or to settle.

Funders and Stakeholders Said Familiarity with the Consumer TPLF Market Has Increased and the Market Is Maturing

Trends in consumer TPLF include increased familiarity with TPLF, a maturing of the market, and increased efforts to regulate the industry at the state level.

- **Increased familiarity with TPLF.** Consumers have become increasingly familiar with consumer TPLF in recent years, according to four consumer litigation funders we interviewed. One funder said this has led to increased competition among funders and lowered the cost of TPLF for consumers. Another funder said lawyers may become more accepting of TPLF as their clients are interested in using it more frequently.
- **Maturing of the market.** The consumer TPLF market is becoming more mature. One trade association said this maturation could be seen through the emergence of securitization in consumer TPLF. Some consumer litigation funders have shifted toward providing TPLF that is funded through securities, which may indicate that the market is attracting more investors.[36] Additionally, one academic researcher told us the consumer TPLF market had matured to the point where

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[36] For example, two consumer funders told us they initially provided funding to consumers using personal money and lines of credit, but in the past 5 years have started using funds raised through the sale of securities. The four largest consumer funders have also successfully securitized their funding transactions over the past 5 years, according to a trade association.

funders are using established business practices, strategies, and technology.

- **Efforts to regulate the industry.** Both opponents and proponents of consumer TPLF have increased efforts to regulate the industry at the state level, according to three consumer litigation funders and three stakeholders. For example, one funder said there has been a movement by TPLF opponents to limit fees that litigation funders can charge consumers. Additionally, one trade association said there have been recent efforts to ban TPLF in some states. Two trade associations said some states have adopted regulations that require clearly stipulated contract terms.[37]

As with the commercial TPLF market, there are no publicly available data on the overall size of the consumer TPLF market. In addition, there have not been any public industry surveys. At least one state (Maine) requires registered funders to report some data about consumer TPLF to a state agency, but the results of that data collection are not publicly available. Consumer litigation funders we interviewed did not have any estimates of the size of the market. Five stakeholders told us they were not clear on whether the industry had grown over the last 5 years.

Experts Identified Data Gaps in the U.S. TPLF Markets and Policy Options to Address Them

Experts that participated in our roundtable and litigation funding associations we interviewed identified several possible gaps in the availability of data on U.S. TPLF markets. Examples of gaps include data on funders' rates of return, the number of funders operating in the U.S., and the total amount of funding provided.

Experts said that addressing these data gaps could help researchers answer important questions about the TPLF industry, such as what effect TPLF has on litigation and the extent to which conflicts of interest arise for judges who hear cases funded by TPLF and have ownership interests in litigation funders. Experts added that obtaining more data also may help address concerns about consumer and investor protections. For example, additional data about consumer funders could provide more transparency and increase market competition. Similarly, additional information on portfolios of publicly traded litigation funders in the commercial TPLF market could improve investor protections. Further, according to one expert, a lack of information about the industry may be the motivating force behind some stakeholders wanting to regulate it, and more data

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[37] We discuss state regulation of consumer TPLF in more detail later in the report.

could provide a greater understanding of TPLF, thereby serving as an alternative to regulation.

Experts identified six policy options to address the data gaps they identified. These options are summarized below and represent potential actions by U.S. lawmakers, regulators, courts, and industry stakeholders. The options are organized by the TPLF market they apply to (commercial, consumer, or both) and describe the parties that could potentially collect or supply the data. The experts and litigation funding associations we interviewed also described potential implementation steps and challenges posed by these options, which also are summarized below.[38]

- **Arbitration institutions could collect data.** Some arbitration institutions have disclosure rules and practices that could provide an avenue for obtaining data on commercial TPLF. However, a litigation funding association we spoke to noted that obtaining data solely from these institutions would give an incomplete picture of the commercial TPLF market.

- **State regulators could collect data.** States could require funders to obtain licenses and report consumer TPLF data as part of licensure requirements. However, an expert noted that it could be difficult to get various states to enact legislation imposing those requirements. A litigation funding association we spoke with also expressed concerns that, depending on what data are collected, this option could result in defendants receiving information about plaintiffs that they would not ordinarily receive. Experts suggested that the funders could report the data on an aggregated, anonymized, or confidential basis.

- **Federal regulators could collect data.** Funders could report TPLF data to federal regulators.[39] For example, experts suggested that the Consumer Financial Protection Bureau (CFPB) may be able to gather data about consumer TPLF. However, litigation funding associations we interviewed questioned CFPB's authority to obtain data from funders and one association said Congress may need to pass legislation to authorize CFPB to do so. An expert also suggested the

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[38] We asked roundtable participants and the litigation funding associations we interviewed to describe the potential advantages and disadvantages of the options, but the discussions primarily focused on potential challenges posed by the options.

[39] We discuss the role of federal regulators later in the report.

Securities and Exchange Commission (SEC) could obtain data from commercial TPLF funders that are subject to SEC regulation.

- **The court system could collect data.** Federal or state courts could collect data about commercial and consumer TPLF. For example, the courts could change their rules to require disclosure of TPLF arrangements or they could collect data through a survey of litigants. One expert suggested that the National Center for the State Courts could help to coordinate among state courts.[40] However, an expert noted that differences in the jurisdiction of state courts could make it difficult to collect standardized data through the state court system. At the same time, collecting data through federal courts alone would not capture cases funded by TPLF that are brought in state courts, according to a litigation funding association. An expert also noted that collecting data through the courts would exclude disputes funded by TPLF that are arbitrated outside of the court system. Another expert also cautioned that this option could create more burden for the courts.[41]

- **Funders could voluntarily provide data.** The judiciary or Congress could send funders a request or survey for data, or funders could be incentivized to voluntarily provide data.[42] However, funders may be unwilling to provide data because of confidentiality concerns or if they were not legally required to divulge such information. Experts also noted that it would be difficult to obtain data from funders without first knowing who the funders are, and that any data collected could suffer from selection bias and would not be representative of all funders.

- **Lawyers or law firms could provide data.** Lawyers or law firms could report TPLF data through state bar registration systems, for example. However, attorneys are subject to confidentiality and ethics requirements that could limit the data they report, according to an expert and a litigation funding association.

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[40] According to its website, the National Center for State Courts is an independent, non-profit organization that works with judicial leaders to promote the rule of law and improve the administration of justice in state courts. National Center for State Courts, About Us, accessed Oct. 10, 2022, https://www.ncsc.org/about-us.

[41] Litigation funding associations we interviewed also expressed concerns that disclosures could give defendants a tactical advantage over plaintiffs, for example, if the funding budget were revealed. We discuss these types of concerns later in the report.

[42] The experts did not provide examples of potential incentives or who would provide them.

The policy options above may not reflect all possible options, but rather those identified by the expert roundtable we convened. Additionally, as with all policy options, they involve trade-offs. As noted above, the options may also require legal action or other steps to implement. For example, federal or state lawmakers may need to pass legislation authorizing relevant agencies to act or compelling disclosure by private parties. Federal or state agencies may need to issue or modify regulations, or in the case of courts, promulgate or modify procedural rules. Some options may require cooperation by nongovernment stakeholders. We did not evaluate how to implement the options or how effective the options would be. Lastly, we discuss existing regulatory and disclosure requirements later in this report.

Funders and Stakeholders Identified Advantages and Disadvantages of TPLF for Its Users and Investors

TPLF Can Help Its Users Access the Legal System and Manage Risks, but It Is Expensive

Commercial and consumer TPLF can offer users several advantages, such as giving underfunded plaintiffs resources to litigate cases against well-funded defendants and allowing plaintiffs to transfer litigation risk, according to literature we reviewed and funders and stakeholders we interviewed. However, consumer and commercial TPLF also can be costly to plaintiffs and defendants, and may create incentives for parties not to reach settlement, according to funders and stakeholders.

Advantages

- **Helps even the playing field for underfunded plaintiffs.** TPLF can help ensure that plaintiffs with limited resources have the funding they need to litigate their cases, according to eight litigation funders, three trade associations, and one academic researcher we interviewed. For example, commercial TPLF can allow a small business with a breach of contract claim against a large corporation, but without funding for a lawsuit, to bring its claim in court.[43] Underfunded corporate plaintiffs can also use it to more effectively litigate complex cases—for example, by using the funding to hire more experienced lawyers or expert witnesses. Similarly, consumer TPLF can help pay living expenses for an injured plaintiff who cannot work during a lawsuit. This can give the plaintiff an opportunity to sustain litigation longer and avoid accepting a low settlement offer.

- **Ability to monetize claims.** A benefit of TPLF for plaintiffs is that it allows them to monetize their claims (that is, convert the value of their claims to cash), according to four litigation funders and two stakeholders we interviewed. This allows plaintiffs to realize the value of their claim upfront instead of having to wait until after they win their case. For example, companies and individuals can use the expected proceeds from a claim for business purposes or living expenses, respectively.
- **Ability to transfer risk to a third party.** TPLF allows plaintiffs to offload some of the risk of negative litigation outcomes to funders.[44] Plaintiffs do not have to pay back the TPLF if they lose their case, which reduces their risk exposure similar to the way defendants transfer risk to their liability insurers.[45]

Funders and stakeholders identified additional advantages for commercial TPLF users. For example, plaintiffs can benefit from the due diligence TPLF funders conduct in assessing the merits of a plaintiff's case, which gives the plaintiff feedback on the case's strengths and weaknesses.[46]

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[43] Some opponents of TPLF have argued that TPLF is not necessary in these instances because in the U.S., plaintiffs can finance their litigation through contingency fee arrangements—where a lawyer agrees to represent a client in exchange for a fixed percentage of their recovery if they win the case. We did not examine whether a law firm's fee is the same or differs when TPLF is involved.

[44] Jayme Herschkopf, "Third-Party Litigation Finance," Federal Judicial Center: Pocket Guide Series (Washington, D.C.: Federal Judicial Center, 2017), https://www.fjc.gov/sites/default/files/materials/34/Third-Party_Litigation_Finance.pdf.

[45] Individuals or companies can transfer the risk of potential claims by purchasing insurance policies. Specifically, an insurance company charges a fee, or an insurance premium, to the policyholder and in return, the insurer assumes certain risks that are defined in the insurance policy. For example, an individual who is injured in a car accident may decide to sue the other driver for damages. If the injured party (the plaintiff) wins the case and the other driver (the defendant) has a car insurance policy, the insurance company would generally help pay for the claim.

[46] Two commercial litigation funders and one trade association told us this screening function can also help decrease the number of frivolous claims filed in court.

Further, TPLF can allow corporate plaintiffs to take litigation costs off their balance sheets, according to two commercial litigation funders.

Disadvantages

- **TPLF is expensive.** TPLF can be costly to obtain.[47] For example, one consumer litigation funder we interviewed has rates starting at 15 percent of the amount funded, according to its website.[48] Another consumer litigation funder we interviewed listed its rates as 18 percent of the amount funded (applied every 6 months). Funders say they charge a high rate for TPLF because they assume a lot of risk. Two funders and one stakeholder noted that if plaintiffs are not careful with how much financing they obtain, the fees associated with the financing could significantly cut into their recovery amount.
- **TPLF may deter settlement.** Plaintiffs who use TPLF may be inclined to reject a fair settlement offer, according to literature we reviewed, one trade association, and one consumer litigation funder.[49] According to the funder, plaintiffs may seek extra money to make up the amount that has to be repaid.
- **Litigation costs for defendants could increase.** Three stakeholders told us TPLF could increase litigation costs for defendants. For example, one trade association told us TPLF could encourage the filing of meritless lawsuits, which would create legal costs for defendants. Another association told us defendants may file additional discovery motions to get access to the TPLF agreement, which could

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[47] As discussed earlier, plaintiffs that win their cases will generally repay the funder the amount of funding they received plus an additional amount based on a return structure outlined in the TPLF agreement.

[48] The funder told us that the total amount a plaintiff will repay is based on the length of time the funding is outstanding and the amount is expressly listed in the TPLF agreement. Several states require this type of information to be set forth in the agreement. For example, under a state statute in Maine, funding agreements must include the total amount that consumers must repay, in 6-month intervals for 42 months, as well as the annual percentage fee on advance. See Appendix III for more information.

[49] Herschkopf, “Third-Party Litigation Finance.”

increase costs.[50] Defendants also may face increased expenses because cases may run longer, since plaintiffs may be less inclined to settle.

Other potential disadvantages for commercial TPLF users, according to two trade associations and a report, include risks that a funder paying for the litigation may exert control over the case (such as influencing decisions about litigation strategy or whether to settle) and that TPLF may lead to conflicts of interest between attorneys and their clients (for example, if the lawyer were to put the funder's interest ahead of the plaintiff's).[51] One of the associations also noted that having sovereign wealth funds invest in the U.S. commercial TPLF market may be a disadvantage because they may seek to influence litigation.[52] Two stakeholders told us that another potential disadvantage of consumer TPLF is consumers not being fully aware of its cost. There is also a risk of funders taking advantage of vulnerable consumers in dire need of financial assistance, according to three stakeholders and one funder.[53]

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[50] Some TPLF opponents have argued that TPLF agreements should be disclosed because the agreements may violate state champerty laws or create conflicts of interest between the plaintiff and their attorneys, among other concerns. Conversely, TPLF proponents have argued that defendants want access to TPLF agreements to gain a tactical advantage over plaintiffs (for example, by learning about the plaintiff's litigation budget). In its consideration of a proposal to require disclosure of TPLF agreements, the Advisory Committee on Civil Rules observed that there is a concern that mandatory disclosure could generate litigation about the adequacy of the disclosure and lead to further attempts to discover more information about the funding arrangement, its origins, and perhaps ongoing implementation of the agreement. *See* Advisory Committee on Civil Rules, Agenda, 354 (Nov. 7, 2017). We discuss TPLF disclosure requirements later in the report.

[51] Congressional Research Service, *Following the Money: Should Federal Law Require Litigants to Disclose Litigation Funding Agreements?* Legal Sidebar, LSB10145 (May 31, 2018).

[52] An article we reviewed also noted that sovereign wealth funds may be involved in TPLF to further foreign policy or military goals. Maya Steinitz, "Follow the Money? A Proposed Approach for Disclosure of Litigation Finance Agreements," *UC Davis Law Review*, vol. 53, no.2 (2019): 1103-1104.

[53] Some states have enacted laws that can help guard against these potential abuses (for example, by capping the amount of interest funders can charge and requiring that contracts clearly disclose the cost of financing). See Appendix III for more information.

TPLF Offers Investors Returns Uncorrelated to Financial Markets, but Investment Risk Can Be High

Commercial and consumer TPLF offers investors potentially high returns and an opportunity to diversify their investment portfolios because the returns are not correlated with financial markets. Funders we interviewed said the primary disadvantage to investors is the high risk of losing the investment.

Advantages

- **High returns.** TPLF can offer high returns, according to most funders and four stakeholders we interviewed. For example, in 2021, one commercial funder reported a 93 percent return on invested capital on concluded assets since inception in one of its portfolios.[54] Another commercial funder reported a 91 percent return on invested capital on completed investments in two of its funds since 2017.[55] Investing in TPLF can offer high returns because these investments are high risk—investors lose all of their investments if the lawsuit is unsuccessful.
- **Returns are uncorrelated to financial markets.** According to eight funders and two stakeholders we interviewed, TPLF has become an attractive market for investors because returns are uncorrelated to the price movements of other investments, such as stocks, bonds, and commodities. Litigation occurs in markets that trend upward or downward and does not depend on macroeconomic factors. As a result, TPLF offers investors an opportunity to diversify their investment portfolio.

Disadvantages

The primary disadvantage of investing in commercial and consumer TPLF is the potentially high risk of losing the investment, according to five funders. Since funders provide TPLF to clients on a nonrecourse basis, if a plaintiff loses the case, the funder loses the money invested in that case.[56]

Another potential disadvantage for investors in commercial TPLF is that it may take a long time to receive a return on investment since cases can

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[54] Buford reported this return for concluded assets in its Burford-only balance sheet capital provision-direct portfolio. Burford defines concluded assets as those in which there is no longer any litigation risk remaining. Burford Capital, *Burford Capital Annual Report 2021* (2022).

[55] The majority of Omni Bridgeway's investments sit within seven funds. Omni Bridgeway, *Annual Report 2021* (2021). This return is generally comparable to the performance of the S&P 500 over a similar time period.

[56] Commercial TPLF investors may face less risk when investing in portfolio arrangements because the return on the investment depends on multiple cases instead of just one.

take several years to resolve. In addition, there is a risk that funders may not have complete information about the cases in which they invest—for example, because they may not be privy to confidential or privileged information from the lawsuit. Another stakeholder told us investors could be misled about a case's prospects and invest in cases less likely to be successful than they believe.

In the U.S. and Selected Foreign Countries, Regulation of TPLF Is Limited

In the U.S., TPLF Is Not Federally Regulated, but Some State Regulation and Industry Best Practices Exist

The TPLF industry is not specifically regulated under federal law. However, the activities of litigation funders may be subject to regulation under laws of more general applicability, such as federal securities laws. According to staff at the SEC, the TPLF industry most commonly intersects with SEC regulation if a litigation funder has public reporting obligations under federal securities laws.[57] For example, the Securities Exchange Act of 1934 (Exchange Act) and related rules and regulations of the SEC govern the registration of securities on national securities exchanges and require issuers to regularly report information about their business, results of operations, and financial condition.[58] Litigation funders that are issuers subject to these requirements may thus be required to disclose information regarding their TPLF activities. SEC identified one such funder, Burford Capital Limited, which is a large commercial litigation funder incorporated in Guernsey that has registered its securities on the New York Stock Exchange pursuant to Section 12(b)

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[57] According to an SEC website, companies are subject to public reporting requirements if they sell securities in a public offering, allow their investor base to reach a certain size, or voluntarily register with the SEC, among other things. Securities and Exchange Commission, *Public Companies* (accessed July 14, 2022, https://www.investor.gov/introduction-investing/investing-basics/how-stock-markets-work/public-companies).

[58] Securities Exchange Act of 1934 (codified as amended at 15 U.S.C. §§ 78a-78qq). Related rules and regulations are codified in scattered sections of chapter II of title 17 of the *Code of Federal Regulations*. *See*, *e.g.*, 15 U.S.C. §§ 78l, 78m, 78o(d), and 17 C.F.R. pt. 249, subpt. D.

of the Exchange Act.[59] The funder files periodic reports with SEC, including an annual report on Form 20-F, which is a report filed by foreign private issuers that discloses financial and other information about the company.

In addition, SEC staff said it is possible that TPLF arrangements could implicate other provisions of federal securities laws and related rules and regulations, depending on the structure of the arrangements and other factors. SEC staff noted, for example, that TPLF arrangements could be "investment contracts" or otherwise constitute securities under federal securities laws. In addition, the SEC issued proposed rules earlier this year, which, if adopted, would require certain registered investment advisors to confidentially report information about investments in litigation finance made by private funds they manage.[60] The preamble to the rules notes the evolution of the private fund industry in the last decade and the increasing prevalence of certain investment strategies, including litigation finance. The preamble states that the new information would be used to support SEC oversight efforts and improve the Financial Stability Oversight Council's ability to address systemic risks to the country's financial stability.[61]

The CFPB regulates the offering and provision of consumer financial products and services, including extensions of credit. CFPB officials told us that whether any given TPLF arrangement is a credit product within CFPB's regulatory authority, as outlined in the Consumer Financial Protection Act of 2010, would depend on the specific facts and

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[59] SEC's Division of Corporation Finance selectively reviews filings under the Securities Act of 1933 and the Exchange Act to monitor and enhance compliance with disclosure and accounting requirements. The Division reviewed Burford Capital Limited's registration statement on Form 20-F, which was declared effective on September 30, 2020. The funder's registration statement and other related documentation are publicly available on SEC's Electronic Data Gathering, Analysis, and Retrieval System.

[60] *See* Amendments to Form PF to Amend Reporting Requirements for All Filers and Large Hedge Fund Advisers, 87 Fed. Reg. 53,832 (Sept. 1, 2022) and Amendments to Form PF to Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Fund Advisors, 87 Fed. Reg. 9,106 (Feb. 17, 2022). The rules propose to collect the information by amending Form PF, a confidential reporting form used by SEC-registered investment advisors that manage private funds and have at least $150 million in private fund assets under management.

[61] Form PF may also be filed with the Commodity Futures Trading Commission (CFTC), for example, if an SEC-registered investment advisor required to file Form PF is also registered with the CFTC as a commodity pool operator or commodity trading adviser.

circumstances.[62] For example, in a 2017 enforcement action against a litigation funder, CFPB stated that certain funding—which had been provided to consumers awaiting payment of an award—was an extension of credit or an offer to extend credit for purposes of the act.[63]

At the state level, there is some regulation of consumer TPLF.[64] For example, some states limit the interest rates and fees that funders can charge consumers who enter into TPLF agreements.[65] Arkansas, for example, caps interest rates at 17 percent, while Tennessee caps annual fees at no more than 10 percent of the original amount of money provided to the consumer.[66] Some states, such as Maine and Nebraska, require consumer litigation funders to register with the state and disclose certain

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[62] *See*, *e.g.*, 12 U.S.C. § 5481(5), (7), (15)(A)(i). We also interviewed Department of Justice officials, who told us they do not interact with litigation funders or engage with the TPLF industry.

[63] *See* Consumer Fin. Prot. Bureau v. RD Legal Funding, LLC, No. 1:17-cv-00890 (S.D.N.Y. filed Feb. 7, 2017). According to the complaint, the defendants offered or provided funds to consumers who were entitled to receive compensation under a settlement fund or judgment and were awaiting payment, and upon receipt of their awards, consumers were required to repay the funding at a considerable premium. The complaint alleged that the defendants engaged in deceptive and abusive acts and practices related to such funding in violation of the Consumer Financial Protection Act of 2010. *See* 12 U.S.C. §§ 5531, 5536(a).

[64] According to literature we reviewed, one state—Wisconsin—has enacted legislation that extends to commercial litigation funding. *See*, *e.g.*, Elizabeth Korchin, Patrick Dempsey, and Eric Blinderman, “The Third Party Litigation Funding Law Review: USA,” (November 22, 2021), accessed July 13, 2022, https://thelawreviews.co.uk/title/the-third-party-litigation-funding-law-review/usa. We discuss this law later in the report and in Appendix III. Also, as discussed earlier, state common law doctrines prohibiting maintenance, champerty or barratry are also relevant.

[65] States may also have separate usury laws, which restrict the amount of interest a lender can charge for a loan. According to a report by the New York Bar Association, litigation funders often avoid running afoul of state usury laws because the funding does not ordinarily involve an absolute obligation to repay. The report identified some instances where courts classified funding agreements as loans subject to state usury laws, but said the majority view was that such laws did not restrict litigation funding. New York City Bar, *Report to the President*, 9.

[66] *See* Ark. Code Ann. §§ 4-57-109, 4-57-104, Ark. Const. amend. 89 § 3 and Tenn. Code Ann. § 47-16-110(a). Tennessee also limits the term of funding transactions to 3 years and the maximum yearly fees funders can charge consumers (which are separate from the annual fee and can include underwriting fees and other charges) to a maximum of $360 per year for each $1,000 of the unpaid principal amount of funds advanced to the consumer. *See* Tenn. Code Ann. § 47-16-110(c).

information in their funding contracts, such as the total amount consumers must repay.[67]

Two consumer litigation funders told us uniform state regulation would make it easier to work across state lines. Other stakeholders noted the challenge of ensuring consumer protections for TPLF while avoiding overregulation that would limit its availability to consumers. See appendix III for more information on state regulation of consumer TPLF.

Trade and professional associations have developed voluntary best practices related to litigation funding. For example, the International Legal Finance Association has developed best practices for commercial litigation funders, which include providing services in a clear manner and not interfering with lawyers' duties to their clients. Similarly, the American Legal Finance Association and the Alliance for Responsible Consumer Legal Funding have developed best practices for consumer litigation funders. Examples of these practices include not providing consumers funding in excess of their needs and not offering or paying commissions or referral fees to any attorney referring clients to a funder. The American Bar Association has also developed best practices for attorneys that use litigation funding. For example, the practices state that attorneys should ensure a litigation funding arrangement is in writing and that the client remains in control of the case.[68]

There Is No Nationwide Requirement to Disclose TPLF Agreements in the U.S, but Some Federal Courts Require Some Disclosure

There is no nationwide requirement to disclose litigation funding agreements to courts or opposing parties in U.S. federal litigation.[69] However, there have been efforts to implement such a requirement. For example, in 2014 and 2017, the U.S. Chamber Institute for Legal Reform and other industry stakeholders proposed that the Advisory Committee on Civil Rules (which drafts rules that govern civil ligation in federal courts) consider an amendment to require disclosure of TPLF arrangements in

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[67] *See* Me Rev. Stat. Ann. tit. 9-A, §§ 12-104, 12-106, and Neb. Rev. Stat. §§ 25-3303, 25-3307.

[68] Though not specific to TPLF, state professional codes of conduct for attorneys may also be relevant. *See* New York City Bar, *Report to the President*, 20-33.

[69] *See, e.g.,* Robin Davis et al., "United States – other key jurisdictions," in *Litigation Funding 2022,* eds. Steven Friel and Jonathan Barnes (London, UK: Law Business Research, Nov. 2021), 131*;* New York City Bar, *Report to the President*, 45; Congressional Research Service, *Following the Money*, 3.

any civil action filed in federal court.[70] The committee did not act on the proposals, but stated that it would continue to monitor TPLF.[71] Federal legislation to require disclosure of TPLF agreements also has been proposed.[72] Some industry stakeholders have called for the mandatory disclosure of TPLF agreements because of concerns that the agreements could create conflicts of interest between plaintiffs and their attorneys and because disclosure could provide additional transparency.[73] However, other stakeholders are concerned that defendants want access to TPLF agreements to gain a tactical advantage in court since they would know how much plaintiffs could spend on litigation.

Despite the absence of a nationwide disclosure requirement, federal courts can still obtain information about TPLF arrangements. For example, the Advisory Committee on Civil Rules has observed that judges can obtain information about third-party funding when it is relevant in a particular case.[74] Additionally, some federal courts have developed local rules or taken other steps to require litigants to disclose information about their TPLF arrangements. Examples include the following:

- **Northern District of California.** In November 2018, the Northern District of California began requiring parties in any class, collective, or

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[70] *See* Advisory Committee on Civil Rules, Agenda 371 (Oct. 5, 2021). Industry stakeholders have since submitted additional proposals, including a 2021 proposal that the committee test TPLF disclosure in federal civil cases through a pilot project. The Advisory Committee on Civil Rules is a component of the federal judiciary that evaluates proposed changes to the Federal Rules of Civil Procedure and prepares draft amendments. It recommends amendments for further consideration within the federal judiciary, which, if approved, are ultimately promulgated by the U.S. Supreme Court.

[71] *See* Advisory Committee on Civil Rules, Agenda, 371-372 (Oct. 5, 2021) and Meeting Minutes 34, 36 (Oct. 5, 2021).

[72] *See, e.g.,* Litigation Funding Transparency Act of 2021, S. 840, 117th Cong. (2021).

[73] According to a report we reviewed, courts generally do not require disclosure of the litigation funding agreement itself and have justified withholding this information as irrelevant or protected by the work product doctrine. New York City Bar, *Report to the President*, 45.

[74] Advisory Committee on Civil Rules, Memorandum 4 (Dec. 2, 2014).

representative action to disclose to the court the identity of any person or entity that is funding the prosecution of any claim or counterclaim.[75]

- **District of New Jersey.** In June 2021, the District of New Jersey adopted a rule requiring litigants who have certain TPLF arrangements to file a statement that (1) identifies the funder, (2) describes whether the funder's approval is needed for litigation or settlement decisions, and if so, the nature of the terms and conditions of that approval, and (3) provides a brief description of the nature of the funder's financial interest.[76]

In addition, several federal courts have developed rules requiring litigants to disclose the identity of outside parties with a financial interest in the outcome of a litigation, according to a report by the New York City Bar Association.[77] The report noted that the purpose of these rules is to allow judges to assess whether there are any conflicts that bear on the judges' recusal and disqualification. The rules do not specifically target TPLF, but may require disclosure of litigation funders' identities, according to the report.

At the state level, at least two states have enacted laws requiring disclosure of TPLF agreements in civil litigation, according to literature we reviewed.[78] In 2018, Wisconsin passed a law requiring a party in a civil action to disclose to the other parties any agreement that provides a contingent right to compensation from the proceeds of the action.[79]

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[75] *See* U.S. District Court for the Northern District of California, Standing Order for all Judges of the Northern District of California on the Contents of Joint Case Management System, § 19 (eff. Nov. 1, 2018).

[76] U.S. District Court for the District of New Jersey, Local Civ. Rule 7.1.1, Disclosure of Third-Party Litigation Funding. A statement is required if any person or entity that is not a party provides funding for some or all of the attorneys' fees and expenses for the litigation on a non-recourse basis in exchange for (1) a contingent financial interest based upon the results of the litigation or (2) a non-monetary result that is not in the nature of a personal or bank loan, or insurance. *See* Local Civ. Rule 7.1.1(a).

[77] New York City Bar, *Report to the President*, 45, 47-49. *See also* Korchin, Dempsey, and Blinderman, "The Third Party Litigation Funding Law Review: USA."

[78] *E.g.*, Ryan M. Billings, Robert L. Gegios, and Melinda A. Bialzik, "Sweeping Changes to Rules of Civil Procedure," *Wisconsin Lawyer*, June 1, 2018, accessed July 14, 2022, https://www.wisbar.org/NewsPublications/WisconsinLawyer/Pages/Article.aspx?Volume=91&Issue=6&ArticleID=26396.

[79] *See* 2017 Wisconsin Act 235, § 12 (codified at Wis. Stat. § 804.01(2)(bg)). The statute excludes certain contingent fee arrangements with attorneys representing a party.

Disclosure is required unless otherwise stipulated or ordered by the court. In 2019, West Virginia amended a state consumer protection law to include a similar requirement for agreements with litigation funders.[80] Other states, such as Texas and Florida, have considered proposed legislation to require disclosure of TPLF agreements.[81]

Regulation of TPLF in Selected Countries Is Limited

We reviewed regulation and disclosure of TPLF in three selected countries—Australia, England, and Canada.[82] The manner and extent of regulation varied. However, the regulation we identified in these countries was limited to certain funders or types of funding, or was not specific to TPLF. The disclosure requirements we identified also varied and applied only in certain circumstances.

Australia

Litigation funders typically fund three categories of claims in Australia, according to representatives of the Association of Litigation Funders of Australia: class actions (involving individuals and companies), insolvency claims for companies under external control and trustees in bankruptcy, and commercial claims. The representatives we interviewed added that single-case and portfolio arrangements for law firms and other businesses are available to clients, but single-case arrangements are the most common.

Data on the total amount of funding committed to litigation finance in Australia are not publicly accessible, according to trade association representatives, but they estimated that between $150 million to $200 million (in U.S. dollars) are invested in Australia's TPLF market annually. They also said that between 10 and 20 litigation funders have been actively funding claims in Australia during the last 5 years.

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[80] *See* Act of March 7, 2019, art. 6N, § 46A-6N-6 (codified at W. Va. Code § 46A-6N-6).

[81] *See*, *e.g.,* Tex. S.B. 1567, 86th Leg. R.S. (2019) and Fla. S.B. 1750 (2021).

[82] We selected these countries because they include a mix of geographic locations and they have a legal system similar to that of the U.S. in some respects, among other factors.

The regulatory environment for litigation funders in Australia is complex and continues to develop, according to literature we reviewed.[83] Funders are subject to certain laws of general applicability but have been specifically exempted from some requirements.[84] For example, the government issued regulations in 2012 that exempted funders from certain requirements focused on conduct and disclosure in relation to financial services and products.[85] This included the requirement to hold a financial services license, among other things. In an effort to increase regulatory oversight, the government issued new regulations in 2020 that removed the exemptions for litigation funding when used in the context of class actions.[86] However, in September of this year, the government released draft regulations that would reinstate the exemptions for class

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[83] *See* Jason Geisker and Dirk Luff, "The Third Party Litigation Funding Law Review: Australia," (November 22, 2021), accessed September 1, 2022, https://thelawreviews.co.uk/title/the-third-party-litigation-funding-law-review/australia, Simon Morris et al., "Australia," in *Litigation Funding 2022,* eds. Friel and Barnes*,* 10-21, and Susanna Taylor, "Litigation funding," Practical Law ANZ Practice Note w-004-7182, accessed Sept. 1 2022, https://anzlaw.thomsonreuters.com.

[84] The literature noted, for example, that funders are subject to certain provisions of law that protect consumers against unfair contract terms and conduct that is misleading or deceptive. Also relevant are general laws, rules, and regulations pertaining to corporate governance, shareholding, and securities exchanges, among others, according to the literature. *See, e.g.,* Geisker and Luff, "The Third Party Litigation Funding Law Review: Australia," and Australian Law Reform Commission, *Integrity, Fairness and Efficiency—An Inquiry into Class Action Proceedings and Third-Party Litigation Funders* (December 2018), 62-63. For a discussion of exemptions related to financial services and credit regimes, see Australian Securities and Investments Commission, *Consultation Paper 345: Litigation funding schemes: Guidance and relief* (July 2021), 6-8, and related resources provided by the Australian Securities and Investments Commission (ASIC), accessed September 20, 2022, https://asic.gov.au/regulatory-resources/managed-funds/litigation-funding-schemes.

[85] *See, e.g.*, Australian Securities and Investments Commission, *PJC inquiry into litigation funding and the regulation of the class action industry* (June 2020), 5-6. The report cites the Corporations Amendment Regulation 2012 (No. 6) (as amended). The report clarifies that services in relation to litigation funding were generally exempt, although litigation funders may have been required to obtain a financial services license for other activities. *See also* Australian Securities and Investments Commission, *Consultation Paper 345: Litigation funding schemes: Guidance and relief*, 6-7.

[86] *See, e.g.,* Australian Securities and Investments Commission, *Consultation Paper 345: Litigation funding schemes: Guidance and relief*, 7-8, citing the Corporations Amendment (Litigation Funding) Regulations 2020 (Cth) (Austl.). *See also* Explanatory Statement, Corporations Amendment (Litigation Funding) Regulations 2020 (Cth) 1-2 (Austl.). The new regulations retained exemptions for funding of insolvency and single-plaintiff matters, according to the explanatory statement.

action funding.[87] According to a media release issued by the government, the changes followed a seminal judicial ruling earlier this year and are intended to facilitate access to justice.[88]

Claimants are required to disclose litigation funding agreements in class actions brought in federal courts, according to literature we reviewed.[89] The trade association we interviewed described the courts' general practice as requiring disclosure in unredacted form to the judge and in redacted form to the defendant. Claimants can redact commercially sensitive information—such as the funding budget—when disclosing the agreement to the defendant, which ensures the latter does not gain a tactical advantage, according to the association and literature we reviewed.[90] The literature noted that courts scrutinize funding arrangements, for example, when litigants seek court approval for a settlement of the class action that involves payment to funders.[91] The association said that, outside of class actions, there are fewer requirements to disclose a TPLF agreement to the court, unless the court deems it necessary for the efficient progress of the claim.[92]

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[87] *See*, *e.g.*, Joint Media Release by the Attorney-General and Assistant Treasurer and Minister for Financial Services, "Unfair hurdles to class action funding unwound," (September 2, 2022), accessed September 23, 2022, https://ministers.ag.gov.au/media-centre/unfair-hurdles-class-action-funding-unwound-02-09-2022. The draft regulations and draft explanatory statement are available on the Australian Treasury's website, accessed September 21, 2022, https://treasury.gov.au/consultation/c2022-308630.

[88] Joint Media Release by the Attorney-General and Assistant Treasurer and Minister for Financial Services, "Unfair hurdles to class action funding unwound." *See also* Taylor, "Litigation funding," Practical Law ANZ Practice Note w-004-7182 (2022), citing *LCM Funding Pty Ltd v Stanwell Corporation Ltd [2022]* FCAFC 103.

[89] *E.g.,* Morris et al., "Australia," in *Litigation Funding 2022,* eds. Friel and Barnes, 11-13, 17. The authors note that disclosure is also required in certain state courts.

[90] *E.g.,* Geisker and Luff, "The Third Party Litigation Funding Law Review: Australia." According to the association, Parts 5 and 6 of the Federal Court Class Actions Practice Note GPN-CA set out the court's expectation in relation to disclosure. Other examples of commercially sensitive information may include the litigation budget, the commission and cost structure, and settlement amounts, according to literature we reviewed and a stakeholder we interviewed.

[91] *See, e.g.,* Taylor, "Litigation funding," Practical Law ANZ Practice Note w-004-7182.

[92] According to literature we reviewed, courts may also be involved in reviewing litigation funding agreements in connection with applications by liquidators or for security for costs. *E.g.,* Taylor, "Litigation funding," Practical Law ANZ Practice Note w-004-7182 and Morris et al., "Australia," in *Litigation Funding 2022*, eds. Friel and Barnes, 13.

England

In England, litigation funders mainly fund plaintiffs in business-to-business disputes or large scale commercial disputes, and plaintiffs typically use the funding to pay lawyers and legal costs, according to representatives of the Association of Litigation Funders of England and Wales, a trade association we interviewed.[93] They told us that plaintiffs are provided single-case and portfolio financing arrangements, with the latter also being used (to a lesser degree) by law firms and other businesses to manage costs and operations.

Association representatives told us the size of England's litigation funding industry is unknown because of a lack of data, but there are likely no more than 20 major litigation funders operating in the market. One industry report noted that the pipeline of court cases and money held by litigation funders increased from 2019 to 2021.[94]

The government has not specifically regulated the TPLF industry in England, according to association representatives. However, the association provides a form of self-regulation.[95] Specifically, the association administers a voluntary code of conduct to be observed by funders that are members of the association.[96] The code sets out standards of practice and behavior, such as capital adequacy requirements and limitations on the funder's ability to terminate a funding

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[93] On its website, the association describes itself as an independent body charged by the Ministry of Justice with delivering self-regulation of litigation funding in England and Wales. *See* Association of Litigation Funders of England and Wales, "About Us," accessed August 23, 2022, https://associationoflitigationfunders.com/about-us/.

[94] Simon Latham and Glyn Rees, "The Third Party Litigation Funding Law Review: United Kingdom: England and Wales (November 22, 2021), accessed June 28, 2022, https://thelawreviews.co.uk/title/the-third-party-litigation-funding-law-review/united-kingdom-england--wales.

[95] *See* News Release, Civil Justice Council, Civil Justice Council Working Group Agrees Code of Conduct on Litigation Funding (Nov. 23, 2011), accessed August 26, 2022, https://www.judiciary.uk/wp-content/uploads/JCO/Documents/CJC/Publications/CJC+papers/CJC+News+Release+-+Code+of+Conduct+for+Litigant+Funders.pdf.

[96] Association representatives told us that membership in the association is voluntary and subject to certain requirements (for example, members must have £5 million in assets under management).

agreement or control litigation.[97] The code was facilitated by the Civil Justice Council, an advisory body sponsored by the Ministry of Justice of England and Wales.[98] Association representatives told us they communicate with the Civil Justice Council about the TPLF market, but there are no formal reporting requirements.

There is no universal requirement that compels a litigant to disclose a litigation funding agreement to an opposing party or the court, according to literature we reviewed.[99] However, the literature noted that disclosures regarding TPLF arrangements may be required in certain circumstances. For example, one report stated that courts are likely to review and scrutinize funding arrangements in collective proceedings, and another described the court's role in determining appropriate funding terms and structures in that context.[100] The literature also noted that a court may require disclosure of a funder's identity, for example, to facilitate payment of an opponent's legal costs.[101] Association representatives told us that, unlike the United States, England has a "loser pays" rule (where the losing party in a lawsuit has to pay the opposing party's legal expenses), and if defendants have concerns about how their costs will be paid if they

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[97] *See* Association of Litigation Funders of England and Wales, *Code of Conduct for Litigation Funders* (Jan. 2018), accessed August 25, 2022, https://associationoflitigationfunders.com/code-of-conduct/documents/.

[98] According to Amey, the code was first published in 2011 and subsequently revised and updated by the association. Matthew Amey, "Third party litigation funding in England and Wales: an overview," Practical Law UK Practice Note 8-521-3304, accessed August 23, 2022, https://uk.practicallaw.thomsonreuters.com.

[99] *See* Friel et al., "England and Wales," in *Litigation Funding 2022*, eds. Friel and Barnes, 42 and Amey, "Third party litigation funding in England and Wales: an overview," Practical Law UK Practice Note 8-521-3304.

[100] Friel et al, "England and Wales," in *Litigation Funding 2022*, eds. Friel and Barnes, 36, 42; Latham and Rees, "The Third Party Litigation Funding Review: United Kingdom-England and Wales."

[101] *See, e.g.,* Friel et al., "England and Wales," in *Litigation Funding 2022*, eds. Friel and Barnes, 42 and Amey, "Third party litigation funding in England and Wales: an overview," Practical Law UK Practice Note 8-521-3304.

win the case, they can apply to the court to learn about the plaintiff's finances.[102]

Canada

According to literature we reviewed, TPLF has been used in Canada for more than ten years including for class actions, insolvency, and commercial litigation (such as breach of contract and intellectual property disputes).[103] The literature did not identify any government agency that specifically regulates the TPLF industry in Canada.[104] However, one report noted that insurance regulators may have oversight of an arrangement if the funder is also providing insurance to the client.[105]

TPLF agreements must be disclosed to the court in class actions and insolvency matters, where TPLF arrangements are subject to court approval, according to literature we reviewed.[106] One report stated that, where funding is disclosed and approved, courts have protected commercial details and allowed defendants to view only a redacted version of the agreement.[107] The literature highlighted the approval requirements for Ontario class actions in particular, which are prescribed

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[102] According to Friel et al., England's rules of civil procedure give courts broad discretion to award payment of an opponent's costs. "If the court decides to make an order in relation to costs, the general rule is that the unsuccessful party will be ordered to pay the costs of the successful party, subject to some exceptions." Friel et al., "England and Wales," in *Litigation Funding 2022*, eds. Friel and Barnes, 39. According to a report by the Congressional Research Service, the general rule in the United States is that each party pays for its own attorney, subject to certain exceptions. Congressional Research Service, *Awards of Attorneys' Fees by Federal Courts and Federal Agencies*, 94-970 (October 22, 2009).

[103] Paul Rand, Pierre-Jérôme Bouchard, and Naomi Loewith, "Canada," in *Litigation Funding 2022*, eds. Friel and Barnes, 31.

[104] *See* Rand, Bouchard, and Loewith, "Canada," *in Litigation Funding 2022,* eds. Friel and Barnes, 31. Hugh Meighen, "The Third Party Litigation Funding Law Review: Canada," (Nov. 22, 2021), accessed February 1, 2022 https://thelawreviews.co.uk/title/the-third-party-litigation-funding-law-review/canada, and Geoff Moysa, "Litigation Funding: Overview," Practical Law Canada Practice Note Overview w-021-3651, accessed July 15, 2022, https://ca.practicallaw.thomsonreuters.com.

[105] Rand, Bouchard, and Loewith, "Canada," in *Litigation Funding 2022*, eds. Friel and Barnes, 31.

[106] *E.g.,* Rand, Bouchard, and Loewith, "Canada," in *Litigation Funding 2022*, eds. Friel and Barnes, 31, 33.

[107] Rand, Bouchard, and Loewith, "Canada," in *Litigation Funding 2022*, eds. Friel and Barnes, 33.

by legislation.[108] Under that framework, the court will not approve an agreement unless the court is satisfied that the agreement is fair and reasonable and does not impair the lawyer-client relationship, among other things.[109] According to one report, the Ontario legislation reflects general principles from case law that are relevant in other parts of Canada.[110]

Agency Comments

We provided a draft of this report to CFPB, the Department of Justice, the Federal Judicial Center, and SEC for review and comment. CFPB, the Federal Judicial Center, and SEC provided technical comments, which we incorporated as appropriate. The Department of Justice did not provide comments.

As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies to the appropriate congressional members and committees, the Director of the Consumer Financial Protection Bureau, the Attorney General, the Director of the Federal Judicial Center, the Chairman of the Securities and Exchange Commission, and other interested parties. In addition, the report will be available at no charge on the GAO website at https://www.gao.gov.

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[108] According to Moysa, the *Class Proceedings Act, 1992*, S.O. 1992, c. 6 was amended effective October 2020 to codify certain approval requirements that existed under common law. Moysa, “Litigation Funding: Overview,” Practical Law Canada Practice Note Overview w-021-3651.

[109] Meighen, “The Third Party Litigation Funding Law Review: Canada.”

[110] Rand, Bouchard, and Loewith, “Canada,” in *Litigation Funding 2022*, eds. Friel and Barnes, 31.

If you or your staff have any questions about this report, please contact me at (202) 512-8678 or clementsm@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix IV.

Michael Clements

Michael E. Clements
Director, Financial Markets and Community Investment

Appendix I: Objectives, Scope, and Methodology

This report describes (1) characteristics of and trends in the commercial and consumer third-party litigation financing (TPLF) markets, (2) data gaps in the markets, and policy options to address them; (3) potential advantages and disadvantages of TPLF for users and investors; and (4) regulation and disclosure of TPLF in the U.S. and selected foreign countries. For purposes of this report, we define TPLF as an arrangement in which a funder that is not a party to a lawsuit agrees to provide nonrecourse funding to a litigant or law firm in exchange for an interest in the potential recovery in the lawsuit. The scope of this report does not include other types of third-party funding for disputes, such traditional loans from banks.

Publicly available data on the TPLF market are limited as there is no central repository of information on funders and no federal law expressly requires all litigation funders to report market data publicly. The total number of litigation funders operating in the U.S. also is unknown because of limited data. Accordingly, to address the first objective, we collected data on TPLF transactions for 2017–2021 from a sample of litigation funders we interviewed (selected based on methods described below). To collect the data, we developed a data collection instrument that we pretested with two commercial and two consumer litigation funders to ensure clarity and understandability. We sent the instrument to all 12 funders we interviewed and received data from four of them.[1] We assessed the reliability of these data by reviewing them for obvious errors and obtaining written responses from the funders on the systems and methods they used to produce the data. We determined that the data we included in the report were sufficiently reliable for purposes of describing TPLF transactions from selected funders for 2017–2021. Data we collected from the litigation funders cannot be generalized to all funders. We also reviewed annual financial reports from the two publicly traded commercial litigation funders we identified (Burford Capital and Omni Bridgeway) for 2016–2020.

Additionally, we reviewed reports by academic researchers, government agencies, and others that we identified through a literature search. We conducted literature searches in January and August 2022 on the TPLF

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[1] We also requested examples of litigation funding agreements from the 12 funders we interviewed. Some funders declined the request for legal reasons (for example, one said disclosing its agreements could put related privileges and protections at risk and potentially harm the underlying litigation). Six funders provided examples of their agreements but omitted or redacted relevant data, such as investment returns, fees, and funding amounts.

markets in the U.S., Australia, England, and Canada. Databases searched included ProQuest, EBSCO, Scopus, Social Science Research Network, and Westlaw Edge. We identified additional reports by conducting internet searches and searching agency websites, and by soliciting recommendations from federal agency officials, trade associations, and other industry stakeholders during the course of interviews.

We also interviewed officials from four federal agencies: the Securities and Exchange Commission, Consumer Financial Protection Bureau, Department of Justice, and Federal Judicial Center, and conducted semistructured interviews with a sample of 12 litigation funders operating in the U.S. (seven commercial and five consumer funders) and 10 industry stakeholders.[2] We compiled a list of funders by reviewing membership directories from litigation funding trade associations, industry rankings, and information published by a third-party funding research initiative. We then selected a judgmental sample of funders based on the following factors: the type of TPLF they provided (to obtain a mix of consumer and commercial litigation funders), ownership information (to obtain a mix of public and private funders), geographic location, rankings by industry experts, and recommendations by trade associations.

We compiled a list of industry stakeholders by reviewing literature and comment letters on TPLF submitted to the Advisory Committee on Civil Rules (a committee that drafts the rules that govern civil litigation in federal courts), and obtaining recommendations from representatives of federal agencies and other stakeholders we met with during our background-gathering process. We then selected a judgmental sample of stakeholders based on their knowledge of the U.S. TPLF market, their perspectives on TPLF (to obtain a mix of TPLF proponents, opponents, and neutral parties), the type of entity (to obtain a mix of trade associations, researchers, and others), and recommendations we received from federal agencies and other stakeholders.

The stakeholders we interviewed were the American Association for Justice, members of the American Bar Association, American Legal Finance Association, American Property Casualty Insurance Association, International Legal Finance Association, members of the New York City

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[2] Industry stakeholders included trade associations, academic researchers, and other groups or individuals who have experience in or knowledge about consumer or commercial TPLF.

Bar Association, U.S. Chamber Institute for Legal Reform, Westfleet Advisors, and Professors Anthony Sebok and Brian Fitzpatrick.[3] Information gathered from the interviews cannot be generalized to all litigation funders or industry stakeholders.

To address the second objective, we convened a virtual roundtable of 12 experts. These experts discussed possible data gaps in the U.S. TPLF markets; whether the gaps need to be addressed and, if so, policy options for addressing them; challenges posed by the options; and potential implementation steps for the options.[4]

To identify a list of experts to select from, we reviewed a list of TPLF industry stakeholders (compiled by the methods described earlier) and reviewed literature. We then conducted internet searches to identify additional information on the experts' experience, education, and published work. We selected the 12 experts for our roundtable based on (1) their published work on TPLF, (2) their knowledge of TPLF (as measured by how long they have worked in their fields and their number of publications on TPLF), (3) their type of work experience (to obtain a mix of varied experiences, such as professors, attorneys, and others), and (4) their perspectives on TPLF (to obtain a mix of roundtable participants with various positions on TPLF).

The 12 experts we selected were Charles Agee, Managing Partner of Westfleet Advisors; Ronen Avraham, law professor at the University of Texas at Austin School of Law and Tel Aviv University; John Beisner, attorney at Skadden, Arps, Slate, Meagher & Flom LLP and author of publications for the U.S. Chamber Institute for Legal Reform; Page Faulk, Senior Vice President of legal reform initiatives at the U.S. Chamber Institute for Legal Reform; Radek Goral, attorney at Dentons; Tripp Haston, attorney at Bradley, Arant, Boult, Cummings LLP; John McCarthy, attorney at Smith, Gambrel & Russell, LLP and member of the New York City Bar Association Litigation Funding Working Group; Lucian

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[3] We also gathered background information from representatives of the firm Chambers and Partners and the Alliance for Responsible Consumer Legal Funding.

[4] We also met with litigation funding associations (the International Legal Finance Association, American Legal Finance Association, and the Alliance for Responsible Consumer Legal Funding) to gather their perspectives about the data gaps and potential advantages and disadvantages of the options the experts identified. We asked roundtable participants and the litigation funding associations we interviewed to describe the potential advantages and disadvantages of the options, but the discussions primarily focused on potential challenges posed by the options.

Pera, attorney at Adams and Reese LLP and ethics advisor for Westfleet Advisors; Victoria Sahani, law professor at Sandra Day O'Connor College of Law, Arizona State University; Anthony Sebok, law professor at Cardozo School of Law and ethics consultant for Burford; Maya Steinitz, law professor at University of Iowa College of Law; and Robert Weber, law professor at Georgia State University College of Law. To help identify any potential biases or conflicts of interest, we asked each expert who participated in the roundtable to disclose whether they had investments, sources of earned income, organizational positions, relationships, or other circumstances that could affect, or could be viewed to affect, their view on the options. For our purposes, there was sufficient variation among the experts' backgrounds and positions on TPLF for the roundtable. The comments of these experts generally represented the views of the experts themselves and not the university, law firm, or other organization with which they were affiliated, and are not generalizable to the views of others in the field.

The roundtable discussions were recorded and transcribed to ensure that we accurately captured experts' statements. We analyzed the transcript to identify common themes related to data gaps identified by the experts and potential options to address them. We then summarized that information in our report. We did not poll expert participants or take votes on approaches discussed during the roundtable. Consequently, we do not provide counts or otherwise quantify the number of experts agreeing to an approach. Further, because experts were generating and discussing ideas as part of a free-flowing group discussion, the number of times a concept was or was not repeated does not necessarily indicate the level of consensus on that concept. In the report, we use the term "experts" to refer to more than one expert.

We did not evaluate the options identified by the experts, such as how effective the options may be or what steps would be required to implement them. Their inclusion in this report should not be interpreted as a recommendation to federal agencies or a matter for congressional consideration. The options are not listed in any specific rank or order. Although the experts identified a range of options for collecting information, other options may exist that were not raised.

To address the third objective, we reviewed reports by academic researchers, government agencies, and others that we identified through a literature search. We also interviewed litigation funders and industry stakeholders. We conducted the literature search and selected the interviewees based on the methods described earlier.

To address the fourth objective, we interviewed the federal agencies and industry stakeholders described above and reviewed legal materials related to TPLF in the U.S., including federal and state laws, federal court rules, proposed legislation, and proposals to amend federal court rules made by industry stakeholders to the Advisory Committee on Civil Rules.[5]

Additionally, we selected a sample of three other countries—Australia, England, and Canada—to review regulation and disclosure of TPLF. We compiled a list of countries to select from by reviewing a list of independent states (countries) maintained by the U.S. Department of State's Bureau of Intelligence and Research, reports on international TPLF markets, and information about the legal systems in different countries. We then selected a judgmental sample of countries to include a mix of geographic locations and types of TPLF regulation (such as government regulation or self-regulation). The selected countries also have a legal system similar to the U.S. in some respects and an established TPLF market (determined through literature we reviewed and interviews with stakeholders).[6] We interviewed officials from the Australian Treasury and representatives from the Association of Litigation Funders of Australia, the Association of Litigation Funders of England and Wales, and the British Columbia Law Institute. We identified these stakeholders through a literature review. Information gathered from these interviews cannot be generalized to all stakeholders in the selected countries we reviewed.

We also reviewed literature about regulation and disclosure of TPLF in the U.S. and the three other countries, including reports by legal practitioners, government agencies, and others.

We conducted this performance audit from April 2021 to December 2022 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that

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[5] We did not conduct a comprehensive survey of state law on TPLF. Also, the fourth objective focuses on requirements pertaining to TPLF funding in the context of litigation rather than arbitration.

[6] According to literature we reviewed, the legal systems of the United States, Australia, England and Canada incorporate common law principles. *See, e.g.*, Nicholas G. Karambelas, "Limited Liability Companies: Law, Practice and Forms," (2021).

the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Members of Commercial and Consumer Third-Party Litigation Financing Trade Associations

Table 1: International Legal Finance Association Members

Funder name	Founding member	Publicly traded company
Burford Capital	✓	●
D.E. Shaw & Co.	−	−
Delta Capital Partners	−	−
Fortress	−	−
Harbour Litigation Funding	✓	−
Innsworth	−	−
Law Finance Group	−	−
Longford Capital Litigation Finance	✓	−
Nivalion	−	−
Omni Bridgeway	✓	●
Parabellum Capital	−	−
Therium	✓	−
TRGP Capital	−	−
Validity	−	−
Woodsford	✓	−

Legend: ✓= founding member of association, ● = publicly traded company, − = not applicable

Source: International Legal Finance Association. | GAO-23-105210

Table 2: American Legal Finance Association Members

Funder name
Barrister Capital
Bridgeway Legal Funding
Broadway Funding Group
Cherokee Funding
Covered Bridge Capital
Cronus Capital
Global Financial
Golden Pear Funding
Grape Leaf Capital
GreenLink Solutions
LawCash
Law Street Capital
LH Funding

Funder name
Magnolia Legal Funding
Mighty
Multi Funding
Multi Funding USA
Mustang Litigation Funding
Necessity Funding
Pegasus Legal Capital
Plaintiff Investment Funding, LLC
Plaintiff Legal Funding
Plaintiff Support
PS Finance
PreSettlement Solutions
Pravati Capital
Prime Case Funding
Resolution Funding
Signal Funding
Thrivest Link
Towncenter Partners LLC
Universal Funds
US Claims Litigation Funding

Source: American Legal Finance Association. | GAO-23-105210

Appendix III: State Laws Addressing Third-Party Litigation Financing

Several states have enacted laws addressing consumer third-party litigation financing. As shown in table 3, these laws may require litigation funders to disclose certain information in their funding contracts, including financial terms such as the amount that must be repaid and the annual percentage rate. States may also require registration or impose reporting requirements. In addition, some states limit the interest rates and fees that litigation funders can charge consumers.

Table 3: Examples of State Laws Addressing Consumer Third-Party Litigation Financing

State	Law	Example of requirements or provisions
Arkansas	Consumer Lawsuit Lending Ark. Code Ann. § 4-57-109	Litigation funders cannot charge consumers annual interest rates greater than 17 percent. Funding contracts must disclose the annual percentage rate applicable to the transaction. Any amount paid to a litigation funder that exceeds the amount provided to the consumer in connection with the dispute must be included as interest.
Maine	Maine Consumer Credit Code Legal Funding Practices Me. Rev. Stat. Ann. tit. 9-A, art. 12	Litigation funders must register with the state. Funding contracts must include the total amount that consumers must repay, in 6-month intervals for 42 months, and the annual percentage fee on advance, compounded semiannually. Litigation funders are prohibited from assessing fees for any period exceeding 42 months from the date of the funding contract. Fees cannot be compounded more frequently than semiannually.
Nebraska	Nonrecourse Civil Litigation Act Neb. Rev. Stat. §§ 25-3301 - 25-3309	Litigation funders must register with the state. Funding contracts must include the total dollar amount to be repaid by the consumer, in 6-month intervals for 36 months, including all fees, and the annual percentage rate of return, calculated as of the last day of each 6-month interval, including frequency of compounding.
Nevada	Consumer Litigation Funding Nev. Rev. Stat. ch. 604C (2021)	Litigation funders must be licensed. The provisions apply to consumer litigation funding transactions that do not exceed $500,000. The litigation funder must require the amount to be paid to be set as a predetermined amount based on intervals of time. The amount may not exceed the funded amount plus charges not to exceed a rate of 40 percent annually. The funding contract must disclose the maximum amount to be assigned by the consumer to the litigation funder and a payment schedule listing all dates and the amount due at the end of each 180-day period from the funding date.
Ohio	Nonrecourse Civil Litigation Advance Contracts Ohio Rev. Code § 1349.55	Funding contracts must include the total dollar amount to be repaid by the consumer, in 6-month intervals for 36 months, including all fees, and the annual percentage rate of return, calculated as of the last day of each 6-month interval, including frequency of compounding.
Oklahoma	Consumer Litigation Funding Agreements Okla. Stat. tit. 14A, art. 3, pt. 8	Litigation funders must obtain a license from the state's Department of Consumer Credit. Funding contracts must include a payment schedule that includes the funded amount and charges, and lists all dates and the amount due at the end of each 180-day period from the funding date until the due date of the maximum amount due to the funder by the consumer to satisfy the amount owed under the agreement.

State	Law	Example of requirements or provisions
Tennessee	Tennessee Litigation Financing Consumer Protection Act Tenn. Code. Ann. tit. 47, ch. 16	Litigation funders must be registered in the state. Funders cannot charge consumers an annual fee that is more than 10 percent of the original amount of money provided to the consumer. The term of funding transactions is limited to 3 years, and the maximum yearly fees funders can charge consumers (which are separate from the annual fee and include underwriting fees and other charges) are limited to a maximum of $360 per year for each $1,000 of the unpaid principal amount of funds advanced to the consumer.
Vermont	Consumer Litigation Funding Companies Vt. Stat. Ann. tit. 8, ch. 74	Litigation funders must register with the state. Funders must file annual reports, which include the number of contracts entered into, the dollar value of funded amounts to consumers and charges under each contract, the dollar amount and number of litigation funding transactions in which the realization to the funder was as contracted, and the dollar amount and number of transactions in which the realization to the funder was less than contracted. Funding contracts must include the total funded amount provided to the consumer under the contract, an itemization of charges, and the annual percentage rate of return.
West Virginia	Consumer Litigation Financing W. Va. Code. ch. 46A, art. 6N	Litigation funders must register with the state. Funding contracts must disclose the total funded amount provided to the consumer under the contract and the total amount due from the consumer, in 6-month intervals for 42 months, including all fees and charges. Litigation funders may not charge the consumer an annual fee of more than 18 percent of the original amount of money provided to the consumer for the litigation financing transaction and a litigation funder may not assess fees for any period exceeding 42 months from the date of the contract with the consumer. Parties to a civil action must disclose to other parties agreements which provide litigation funders a contingent right to compensation from the proceeds of the action.
Wisconsin	2017 Wisconsin Act 235, § 12 Wis. Stat. § 804.01(2)(bg)	Parties to a civil action must disclose to other parties in the action agreements which provide to any person—other than an attorney permitted to charge a contingent fee representing a party—a contingent right to compensation from the proceeds of the action.[a]

Source: GAO analysis of state laws. | GAO-23-105210

Note: This table reflects the referenced laws as of November 4, 2022 and is not exhaustive. Other states may have enacted laws that address consumer third-party litigation financing.

[a] The related statutory provision does not expressly distinguish between agreements that are consumer or commercial in nature. According to literature we reviewed, Wisconsin is the only state to require litigation funding disclosure in commercial litigation. *See*, *e.g.*, Elizabeth Korchin, Patrick Dempsey, and Eric Blinderman, “The Third Party Litigation Funding Law Review: USA,” (November 22, 2021), accessed July 13, 2022, https://thelawreviews.co.uk/title/the-third-party-litigation-funding-law-review/usa.

Appendix IV: GAO Contact and Staff Acknowledgments

GAO Contact

Michael E. Clements, (202) 512-8678 or clementsm@gao.gov

Staff Acknowledgments

In addition to the contact named above, John Forrester (Assistant Director), Erika Navarro (Analyst in Charge), John Karikari, Jill Lacey, Evan Nemoff, Kirsten Noethen, Jennifer Schwartz, and Jena Sinkfield made key contributions to this report.

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August 30, 2024

Judge Harvey Brown
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Judge Brown,

Over the past several years, the International Legal Finance Association's (ILFA)[1] members have advocated on behalf of the commercial legal finance industry. Such advocacy includes appearing before the Federal Advisory Committee on Civil Rules of the Committee on Rules of Practice and Procedure (Civil Rules Advisory Committee),[2] the Uniform Law Commission (ULC), as well as before Congress and state legislatures across the country, including in Texas.

While ILFA does not oppose reasonable disclosure requirements, ILFA believes that disclosure requirements should be appropriately tailored and consistent with the Rules of Civil Procedure and applicable law and that there should not be special disclosure rules targeting litigation funders, as opposed to banks or other providers or capital, or any entity with a financial stake in the outcome of a matter. The facts surrounding how a party finances its litigation – whether self-funded, contingency, traditional bank loan, legal finance, or otherwise – are simply not relevant to the merits of the litigation in the vast majority of cases. Despite highly politicized efforts to mandate disclosure in various forms, careful examination of the topic has yielded a consensus view among neutral organizations – including the Civil Rules Advisory Committee and others – that existing disclosure mechanisms are adequate for the vast majority of federal cases.

Federal Courts have differing opinions on forced disclosure

The Texas Civil Justice League (TCJL) overstates the current state of federal rules requiring disclosure. Only the United States District Court for the District of New Jersey has adopted a local rule requiring disclosure of the existence of funding. One judge in the United States District Court for the District of Delaware issued a standing order applicable to his cases, which largely mirrors the New Jersey rule. The United States District Court for the Northern District of California, like

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[1] Founded in September 2020, ILFA is the only global association of commercial legal finance companies. ILFA is a non-profit trade association that promotes the highest standards of operation and service for the commercial legal finance sector, including respecting duties to the courts, avoiding conflicts of interest, and preserving confidentiality and legal privilege.

[2] The Civil Rules Advisory Committee is within the Judicial Conference. Accordingly, "[w]hile the policy conclusions of the Judicial Conference may not be binding on the lower courts, they are at the very least entitled to respectful consideration." *See Hollingsworth v. Perry*, 558 U.S. 183, 193-94 (2010).

several other courts, has a disclosure rule that is broader than Federal Rule of Civil Procedure 7.1, but even then only requires the disclosure of litigation funding in very limited circumstances.[3] Moreover, federal courts across the country have issued dozens of opinions analyzing disclosure of financing under Federal Rule of Civil Procedure 26(b)(1), which have yielded an ever-growing body of precedent holding disclosure of litigation finance unwarranted absent special circumstances. In the select circumstances where courts have deemed disclosure, they have exercised their inherent authority to implement orders that narrowly limit disclosure in a manner that promotes judicial economy, follows Rule 26's requirements of relevance and proportionality, and respects bedrock principles of attorney-client privilege and work-product privilege.

Significantly, federal courts in Texas have resisted efforts to make litigation finance subject to disclosure. The Northern District of Texas has a broad disclosure rule – not specifically directed at litigation funding – that requires the disclosure of all legal entities that have a financial interest in the outcome of the case, but it has not required production of documents related to litigation funding.[4] Similarly, the Western District of Texas has consistently denied motions to compel production of information related to litigation funding.[5] The Eastern District of Texas has also forbidden parties from requesting funding information.[6]

For example, in *Lower48 IP LLC v. Shopify, Inc.*, Shopify requested the court issue an order compelling Lower48 to disclose all third-party interests involved in the action. [7] Judge Ezra adopted Magistrate Judge Gilliland's order that recommended denial of the motion, noting, "none of the judges of the Western District of Texas have ordered the production of [disclosure of all third-party financial interests]." Judge Ezra also noted that there is no Fifth Circuit precedent for this type of disclosure.

Efforts before the Civil Rules Advisory Committee to amend the Federal Rules of Civil Procedure to mandate disclosure have been persistent yet unsuccessful. In 2014, 2015, 2017, 2018, 2019, 2020, 2021, 2022, 2023, and 2024, the United States Chamber of Commerce's Institute for Legal Reform (Chamber) has lobbied the Civil Rules Advisory Committee to force disclosure of funding arrangements in all civil cases. After multiple in-depth studies of the topic, including the creation of a subcommittee that undertook a roadshow across the country to examine the disparate

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[3] *See InfoExpress, Inc. v. Cisco Sys.*, No. 4:23-CV-02698-YGR (N.D. Cal. May 20, 2024) (holding that litigation funder need not be disclosed unless it has the ability to control settlement negotiations). As litigation funding agreements generally do not grant the funder settlement control, the N.D. Cal. rule does not generally require the disclosure of litigation funding.

[4] *See Mobile Telecomms. Techs. LLC v. Blackberry Corp.*, No. 3:12-cv-01652 (N.D. Tex. Nov. 2, 2015) (granting litigation funder's motion to quash subpoena).

[5] *See, e.g., Advanced Aerodynamics, LLC v. Spin Master, Ltd.*, No. 6:21-cv-00002-ADA (W.D. Tex. Feb. 4, 2022) (denying discovery into funding).

[6] *See, e.g., Fleet Connect Solutions LLC v. Waste Connections US, Inc.*, No. 2:21-cv-00365-JRG, (E.D. Tex. Jun. 29, 2022) (denying discovery into funding).

[7] *See Lower48 IP LLC v. Shopify, Inc.*, No. 6:22-cv-00997-DAE, 2023 U.S. Dist. LEXIS 240862 (W.D. Tex. Nov. 2, 2023).

views on the topic at several academic conferences, the Civil Rules Advisory Committee has repeatedly declined to recommend amending the Rules to force disclosure.

For instance, in 2014, the Civil Rules Advisory Committee's reporter stated that "a disclosure regime that applies in every case except those exempted by Rule 26(a)(1)(B) might seem far too broad to address the concern[s] raised."[8] Further, in his Report to the Standing Committee on Rules of Practice and Procedure, the Honorable David G. Campbell remarked that "judges currently have the power to obtain information about third-party funding when it is relevant in a particular case."[9]

In 2016, the Civil Rules Advisory Committee again declined to take action when the Chamber renewed its proposal. The Committee acknowledged the Chamber's "suggestion follow[ing] up an earlier submission that the Committee should act to require disclosure of third- party financing arrangements."[10] Nonetheless, "[t]he Committee decided, as it had earlier, that this topic should remain open on the agenda without seeking to develop any proposed rules now."[11]

In its examination of the topic in June 2019, the MDL Subcommittee of the Civil Rules Advisory Committee declined to make any proposals – including proposals to supplement Rule 7.1 regarding recusal decisions – stating:

> The MDL Subcommittee continues to study third-party litigation funding (TPLF), including various proposals for disclosure. All that is clear at the moment is that the underlying phenomena that might be characterized as third-party funding are highly variable and often complex. They continue to evolve at a rapid pace as large third-party funders expand dramatically. It seems clear that more study will be required to determine whether a useful disclosure rule could be developed. Nor does it seem likely that the several advisory committees will soon be in a position to frame possible expansions of disclosure requirements designed to support better informed recusal decisions.[12]

As mentioned above, the Chamber has perennially urged the Civil Rules Advisory Committee to take various steps toward requiring disclosure. Notably, the Civil Rules Advisory Committee has not found it appropriate to take up the issue.

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[8] *See* Advisory Committee on Civil Rules, Rule 26(a)(1)(A): Reporter's Memorandum & Suggestion, 14-CV-B at 10 (Oct. 30-31, 2014).
[9] *See* Hon. David G. Campbell, Report of Advisory Committee on Civil Rules, at 4 (Dec. 2, 2014).
[10] *See* Advisory Committee on Civil Rules, April 14, 2016 Minutes, at 35 (Apr. 14, 2016).
[11] *Id.*
[12] *See* Hon. John D. Bates, Report of the Advisory Committee on Civil Rules, at 2-3 (June 4, 2019)

Very limited disclosure rules have been adopted in two MDL cases

In its 2022 letter, TCJL pointed to recent MDL cases that have required the disclosure of litigation funding. The judges in these cases utilized their inherent authority in an appropriately limited way to obtain information necessary for the administration of the MDL. Two notable examples of this inherent authority in use are the *Opioids* and *Zantac* MDLs.[13]

In the *Opioids* MDL, Judge Dan Polster had reason to believe that attorneys in the MDL had received, or were interested in receiving, funding. Judge Polster issued a court order explicitly stating that "[a]bsent extraordinary circumstances, the Court will not allow discovery into [funding]."[14] Instead, he required *ex parte* disclosure of funding arrangements for *in camera* review consisting of affirmations by counsel and financier that the funding does not:

(1) create any conflict of interest for counsel,
(2) undermine counsel's obligation of vigorous advocacy,
(3) affect counsel's independent professional judgment,
(4) give to the [funder] any control over litigation strategy or settlement decisions, or
(5) affect party control of settlement.[15]

Similarly, in the *Zantac* MDL, Judge Robin Rosenberg issued a pretrial order in connection with MDL leadership applications requiring the provision of affidavits from counsel for *in camera* review.[16] The order required attorneys utilizing funding to respond to the following prompts:[17]

(i) Does the litigation funder have any control (direct or indirect, actual or apparent or implied) over the decision to file or the content of any motions or briefs, or any input into the decision to accept a settlement offer?
(ii) Does the financing
  (1) create any conflict of interest for counsel,
  (2) undermine counsel's obligation of vigorous advocacy,
  (3) affect counsel's independent judgment,
  (4) give to the lender any control over litigation strategy or settlement decisions (as to either the common benefit work done by counsel or work for individual retained clients), or
  (5) affect party control of settlement?

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[13] *See In re Nat'l Prescription Opiate Litig.*, No. 1:17-MD-2804, 2018 U.S. Dist. LEXIS 84819 (N.D. Ohio May 7, 2018); *In re Zantac (Ranitidine) Prods. Liab. Litig.*, No. 2924, 2020 U.S. Dist. LEXIS 62805 (S.D. Fla. Apr. 3, 2020).
[14] *See In re Nat'l Prescription Opiate Litig.*, 2018 U.S. Dist. LEXIS 84819, at *46.
[15] *See id.* at *45.
[16] *See In re Zantac (Ranitidine) Prods. Liab. Litig.*, 2020 U.S. Dist. LEXIS 62805, at *40.
[17] The *Zantac* order also required disclosure of details concerning leadership applicants' personal and financial relationships with clients and parties.

(iii) Briefly explain the nature of the financing, the amount of the financing, and submit a copy of the documentation to the Special Master.

In both cases, the courts required specific, limited disclosure *in camera* on an *ex parte* basis. This sensible approach balanced the courts' obligation to inquire into financing arrangements for specific, narrow purposes against the reality that funding issues are rarely relevant to the parties' claims and defenses. Judges within the State of Texas already may elect to employ similar mechanisms as they deem fit, whether or not a new rule is enacted.[18]

Both the *Opioids* and *Zantac* orders were positively received as thoughtful and balanced methods to address disclosure. Most importantly, no record exists of either court taking issue with any aspect of any disclosed funding arrangement.

Texas courts have a long history of permitting champerty and maintenance

The body of law in Texas allowing champerty is well settled, originating in the Republic of Texas when courts looked to the law of Spain.[19] With over 150 years of permissible champerty in Texas[20], and all champertous devices permissible with limited exceptions[21], there is little caselaw in existence.

The Uniform Law Commission has declined to adopt model rules, while the American Bar Association prematurely adopted best practices

The ULC[22] has twice formed committees to study this issue and declined to proceed with proposing uniform state legislation on both occasions. As recently as July 2020, the ULC noted that "the topic remains highly politically charged" and "the committee did not receive reports of

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[18] Indeed, the Proposed Rule itself acknowledges the court's inherent authority, providing in Section (c) that "[n]othing herein precludes the Court from ordering such other relief as may be appropriate."
[19] *See, e.g.,* White v. Gay's Executors, 1 Tex. 384, 388 (1846).
[20] *Bentinck v. Franklin* contains the earliest direct declaration from a Texas court regarding the champerty doctrine in that state. 38 Tex. 458, 472 (1873) ('The law [prohibiting champerty] has not been recognized as in force in this State by any of the former decisions.").
[21] "[W]hile the 'practicalities of the modern world have made free alienation ... the general rule,... they have not entirely dispelled the common law's reservations to alienability, or displaced the role of equity or policy in shaping the rule."' *Coronado Paint Co. v. Global Drywall Sys., Inc.*, 47 S.W.3d 28, 31 (Tex. App.-Corpus Christi 2001, pet. denied) (quoting *Gandy*, 925 S.W.2d at 707). *PPG Indus., Inc. v. JMB/Houston Ctrs. Partners Ltd. P'ship*, 146 S.W.3d 79 (Tex. 2004). *Coronado Paint Co.* lists the five public policy exceptions in existence in 2001. *Coronado Paint Co.*, 47 S.W.3d at 31. *PPG Industries* represents the sixth exception, added three years after *Coronado Paint Co. PPG Indus*., 146 S.W.3d at 91-92 ('The DTPA is primarily concerned with people-both the deceivers and the deceived. This gives the entire act a personal aspect that cannot be squared with a rule that allows assignment of DTPA claims as if they were merely another piece of property.") (footnote omitted).
[22] Although the ULC proposes uniform state law legislation, its mission involves "strengthen[ing] the federal system by providing rules and procedures that are consistent from state to state but that also reflect the diverse experience of the states." *See* https://www.uniformlaws.org/aboutulc/overview.

a lack of uniformity [concerning legal finance] causing any problems."[23]

In August 2020, the American Bar Association's House of Delegates voted to approve the best practices for third-party litigation funding. ABA is right to educate lawyers about the use of third-party litigation funding, and has sought to provide best practices in the past. However, in this instance ABA's new best practices were drafted without an opportunity for comment and with the glaring omission of commercial legal finance providers. Not surprisingly, the resulting best practices do not reflect how legal finance actually works and could create confusion among lawyers considering it — the opposite of what was intended. The best practices fail to account for the fact that legal finance has been permitted and endorsed in many U.S. states since they separated from England.

Furthermore, the ABA attempts to provide a single set of best practices for the funding of disputes between commercial entities and consumer litigation funding. These are entirely different practices. Commercial legal finance companies provide multimillion-dollar nonrecourse investments to companies and law firms represented by world-class counsel. Consumer litigation funders make small-dollar cash provisions to individuals in economic distress who may not be experienced in or savvy about negotiating legal transactions.

The Chamber has failed to convince Congress to pass similar legislation

Attempts to pass federal legislation to mandate disclosure have likewise failed. For example, the Chamber-supported Litigation Finance Transparency Acts of 2018 and 2019 would have required disclosure of the identities of funders and the funding agreements in a class action or multidistrict litigation.[24] No version of the bill has ever progressed beyond referral to the Senate Judiciary Committee.[25]

The inability of any Chamber-supported forced disclosure legislation to advance in Congress can be attributed, at least in part, to the threat such a mandate presents to the constitutional rights of litigants. In a letter (attached) to the sponsors of the Litigation Finance Transparency Act, thirteen state Attorneys General, (including Texas Attorney General Ken Paxton) expressed the following First Amendment concerns with a legislative proposal that would have required automatic forced disclosure of a private litigant's financial resources:[26]

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[23] *See* Cassandra Burke Robertson, Memorandum to Study Committee on Third-Party Funding of Litigation and Arbitration (May 20, 2020).

[24] *See* https://www.congress.gov/bill/115th-congress/senate-bill/2815/text; https://www.congress.gov/bill/116th-congress/senate-bill/471/text.

[25] *See* https://www.congress.gov/bill/115th-congress/senate-bill/2815/actions; https://www.congress.gov/bill/116th-congress/senate-bill/471/actions. We note that the Litigation Funding Transparency Act was reintroduced in March of 2021. *See* https://www.grassley.senate.gov/news/news-releases/lawmakers-reintroduce-litigation-funding-transparency-bill.

[26] See attached.

> Although the legislation's intended goal of transparency is laudable, we believe that mandating automatic forced disclosure of a private litigant's financial resources will open the door to threats, intimidation, harassment, and ultimately the chilling of donor support for charitable causes and public interest organizations.
>
> We know from experience that forced disclosure laws like that proposed by the LFTA and similar forced disclosure bills—which would mandate that parties in litigation, without a discovery request or a ruling on relevancy or privilege, disclose the details about their private financial arrangements—can easily become political weapons and bureaucratic tools for delay and harassment, restricting freedom of speech and association and eroding attorney-client privilege and other important confidentiality rules. While we support efforts to thwart abuses of our court system by bad actors, including foreign adversaries, we are concerned that the LFTA as written could too easily be used to frustrate causes that we support. It was not so long ago that IRS regulations were weaponized to stonewall, target, and discriminate against Tea Party groups, and government officials in Wisconsin used the state's "John Doe" laws in a stunning abuse of power to muzzle political opponents.
>
> As you well know, the threat of forced disclosure chills the associational and speech rights guaranteed by the First Amendment. In recent years, we have seen an onslaught of free speech-chilling proposals, such as H.R. 1, the AMICUS Act, and the DISCLOSE Act, which would give the government unprecedented power to surveil the giving and beliefs of American citizens and the organizations with which they support and associate. In fact, two years ago, the Supreme Court struck down an attempt by California to force nonprofit organizations to disclose their donor lists because doing so violated the First Amendment. Unfortunately, we believe the proponents of this dangerous agenda would use the LFTA or similar forced disclosure provisions, if enacted, as one step down a dangerous road to silencing those with certain viewpoints – primarily conservative viewpoints.

Most states, including Texas, have declined to pass mandatory disclosure laws

While the TCJL points out that some states have passed various versions of litigation funding disclosure laws, the majority of states have declined to adopt any version of such a policy. Most importantly, the legislative history in Texas clearly illustrates a strong resistance to this legislative proposal.

The Texas Legislature has demurred on enacting legislation related to this issue since 2005:

1. 2005, House Bill 2987 prohibited usurious lawsuit loans (died in Senate).[27]
2. 2013, House Bill 1595 required licensure of litigation funding entities and prescribed terms (died in House).[28]
3. 2015, Senate Bill 1282 regulated litigation funders and imposed interest rate cap (died in House).[29]
4. 2017, no legislation was filed.
5. 2019, House Bill 2096 and Senate Bill 1567required disclosure, but did not set rate cap (Neither moved out of committee).[30]
6. 2021, no legislation was filed.
7. 2023, no legislation was filed, despite TCJL letter requesting action by Supreme Court Advisory Committee in 2022.

The inability of the proponents of this rule to pass, propose, or advance any legislation in Texas since 2005 is a clear signal to the Supreme Court Advisory Committee that the regulation or disclosure of litigation finance is not supported by the members of the legislative body of Texas.

Forced disclosure proposals threaten long standing work product protections

The proposed rule could effectively authorize discovery into funding materials that courts have repeatedly afforded work-product privilege.[31] In doing so, the proposed rule improperly substitutes the exacting "substantial need" standard for piercing work product with a more relaxed requirement. This constitutes an improper abrogation of work-product privilege under Rule 192.5.[32]

Even in the rare circumstances where funding agreements may be considered relevant, state and federal courts across the country have consistently held that such agreements, along with communications and documents exchanged among litigants and their funders, are entitled to work-product privilege.[33] These documents are protected as they were prepared because of litigation and reflect the mental impressions of counsel.[34] While work-product privilege is not absolute, it may only be overcome pursuant to Rule 192.5(b)(2) where a party "shows that it has substantial need for the materials to prepare its case and cannot, without undue hardship, obtain their substantial equivalent by other means." Any reasonable policy proposed by the Supreme Court

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[27] See https://capitol.texas.gov/BillLookup/History.aspx?LegSess=79R&Bill=HB2987

[28] See https://capitol.texas.gov/BillLookup/History.aspx?LegSess=83R&Bill=HB1595

[29] See https://capitol.texas.gov/BillLookup/History.aspx?LegSess=84R&Bill=SB1282

[30] See https://capitol.texas.gov/BillLookup/History.aspx?LegSess=86R&Bill=HB2096; https://capitol.texas.gov/BillLookup/History.aspx?LegSess=86R&Bill=SB1567

[31] *See, e.g., Hardin v. Samsung Elecs. Co., Ltd.*, No. 2:21-CV-00290-JRG, 2022 U.S. Dist. LEXIS 194602 (E.D. Tex. Oct. 25, 2022).

[32] See Tex. R. Civ. P. 192.5.

[33] *United States ex rel. Fisher v. Ocwen Loan Servicing, LLC*, No. 4:12-CV-543, 2016 U.S. Dist. LEXIS 32967, at *16 (E.D. Tex. Mar. 15, 2016).

[34] See Tex. R. Civ. P. 192.5(b)(1)

Advisory Committee should not diminish the long-standing protection afforded to an attorney's work product.

Forced disclosure rules would cause an increase in speculative motion practice

Beyond the fact that a proposed rule mandating forced disclosure is unnecessary, its implementation would increase burdensome and speculative motion practice regarding legal finance. Across the country, unsupported conjecture concerning legal finance often inspires parties to demand disclosure. Such efforts are typically motivated by voyeurism and the desire to uncover prejudicial information. These efforts rarely succeed, and instead needlessly consume judicial and party resources.

One can only assume that such a rule will embolden movants' fishing expeditions, driving discovery disputes that compound court congestion and increase the cost of litigation. Disclosures will give movants a starting place to propound document requests and interrogatories, ask deposition questions, and/or issue subpoenas to funders with increased frequency. Their efforts will be met with relevance, proportionality, and privilege objections. If unresolved, such objections will necessitate judicial intervention. As discussed above, judges presiding over such motions would invariably need to expend time and resources to determine whether the requested disclosure is appropriate under Rule 192.5, sometimes performing *in camera* review, given the sensitive nature of the documents in question. Motion practice will distract counsel and the judiciary from substantive case issues. Recipients of funding would also shoulder the burden through the need to finance increased legal fees.

To be clear, how a party finances its litigation is not relevant to the merits of the litigation in the vast majority of cases. The majority of case law holds that legal finance is outside the scope of permissible and proportional disclosure unless it is relevant to a particular case.[35] Furthermore, even in the rare circumstances where legal finance may be relevant, courts regularly deny disclosure on the basis of work-product protection.[36]

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[35] *See*, *e.g.*, *AVM Techs., LLC v. Intel Corp*., No. 15-33-RGA, 2017 U.S. Dist. LEXIS 65698, at *8-9 (D. Del. Apr. 29, 2017) (finding litigation funding agreements to "have no relevance"); *Colibri Heart Valve LLC v. Medtronic CoreValve LLC, et al,* Case No. 8:20-cv-00847 (C.D. Cal. Mar. 26, 2021) (finding litigation finance documents not discoverable; defendant's "skepticism" that plaintiff's discovery responses were not accurate or complete did not demonstrate the requisite relevance of the funding documents to the claims and defenses in the matter); *MLC Intellectual Prop. LLC v. Micron Tech., Inc.*, No. 14-cv-03657, 2019 WL 118595, at *2 (N.D. Cal. Jan. 7, 2019) (finding that defendant's attempts to establish relevance based on potential bias and conflicts of interest concerns were speculative); *Miller UK Ltd. v. Caterpillar, Inc.*, 17 F. Supp. 3d 711, 724 (N.D. Ill. 2014) (rejecting discovery into litigation funding arrangements; noting defendant's assertion of relevance lacked "any cogency"); *VHT, Inc. v. Zillow Group, Inc.*, No. C15-1096JLR, 2016 WL 7077235, at *1 (W.D. Wash. Sept. 8, 2016) (rejecting discovery into litigation funding arrangements absent "some objective evidence that any of Zillow's theories of relevance apply in this case").

[36] *See*, *e.g.*, *Elm 3DS Innovations Ltd. Liab. Co. v. Samsung Elecs. Co. Ltd.*., No. 14-1430-LPS, 2020 U.S. Dist. LEXIS 216796 (D. Del. Nov. 19, 2020) (finding some documents reviewed *in camera* to be "marginally relevant to the claims and defenses" yet "clearly prepared in anticipation of litigation" and "thus protected by the work product doctrine");

The Texas Supreme Court has also given a very broad interpretation of work-product privilege as it relates to the discovery of financial documents of an attorney when it ruled that, "A request for all billing invoices, payment logs, payment ledgers, payment summaries, documents showing flat rates, and audits" is analogous to the request in *Valdez*[37] for an attorney's entire litigation file. These billing records, which are generated in anticipation of litigation and trial, are "almost certain to encompass numerous irrelevant and immaterial documents."[38] In other words, in the exceptional case where cause for disclosure exists, that inquiry cannot be resolved without a Rule 26(b)(1) analysis. The proposed rule would not alter the need for or outcome of this analysis; it would merely promote the expenditure of increased resources on a topic that already receives excessive attention, given its marginal relevance, if any, to the merits of litigation.

The Chamber speculatively claims that unscrupulous foreign actors are behind litigation finance

The Chamber, the insurance industry, and big tech make the wildly speculative claim that foreign adversaries are funding lawsuits for the purpose of extracting confidential information from American companies, and that litigation funding is a potential threat to national security. This is simply untrue.

First, there is zero evidence that a hostile foreign state has invested in litigation financing in this country, whether directly or through a passive investment in a litigation finance company, for the purpose of gaining access to proprietary information. In fact, the U.S Chamber's own witness was forced to admit under oath that these allegations are merely speculative and evidence-free.[39]

Litigation finance firms do not control the operation of the cases in which they invest, and they have no access to confidential materials produced in discovery. Their role is to evaluate and select those cases that are more likely to be successful, and sometimes to aid the party with identifying specialty counsel and experts. The investors in litigation finance firms are even further attenuated from the active cases. These passive investors have no role in the selection of individual cases, much less the materials produced via discovery.

Lambeth Magnetic Structures, LLC v. Seagate Technology (US) Holdings, Inc., Nos. 16-538, 16-541, 2017 U.S. Dist. LEXIS 215773, at *15-16 (W.D. Pa. Jan. 18, 2018) (denying motion to compel funding materials because they were "undisputedly prepared in anticipation of the instant litigation and for the purpose of pursuing the litigation"); *Devon IT, Inc. v. IBM Corp.*, No. 10-2899, 2012 U.S. Dist. LEXIS 166749, at *2-3 (E.D. Pa. Sep. 27, 2012) (granting motion to quash subpoenas to funders where "there was no waiver of the attorney-client privilege or the work product doctrine").

[37] *See National Union Fire Ins. Co. v. Valdez*, 863 S.W.2d 458, 1993 Tex. LEXIS 114, 36 Tex. Sup. J. 1321

[38] See In re *Nat'l Lloyds Ins. Co.*, 532 S.W.3d 794, 2017 Tex. LEXIS 522, 60 Tex. Sup. J. 1165, 2017 WL 2501107

[39] See witness testimony from David Meyerson of the U.S. Chamber of Commerce in the Nevada State Senate, March 14, 2023, available at https://www.leg.state.nv.us/Session/82nd2023/ Minutes/Senate/JUD/Final/454.pdf at page 24.

Confidential information that may be relevant to litigation is already protected from improper disclosure through protective orders that strictly limit access, and American courts regularly craft orders to address these concerns.

Conclusion:

In conclusion, ILFA submits that the adoption of a forced disclosure rule would not be in the best interests of the Texas judiciary or the parties and attorneys appearing before it. The policymaking branch of Texas government has demurred on adopting any form of legislation regulating or enacting litigation finance disclosure requirements for the last nineteen years. Current jurisprudence in Texas allows for a judge to order the disclosure of litigation finance agreements if it is relevant to the case. Finally, adopting a carte blanche disclosure requirement will significantly diminish the first amendment rights of litigants as well as invite an unnecessary flood of speculative fishing expeditions that will further delay our already clogged court system.

Thank you for considering the issues we have identified in this letter. We stand ready to help you, as well as the full Supreme Court Advisory Committee, develop a policy that carefully addresses the legitimate needs of litigants and the judiciary of Texas.

In your service,

Kent Hance

Kent Hance

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April 12, 2023

The Honorable Charles Grassley
135 Hart Senate Office Building
Washington, D.C. 20510

The Honorable Darrell Issa
2108 Rayburn House Office Building
Washington, D.C. 20515

Dear Senator Grassley and Representative Issa:

We write to express our concerns about S. 840/H.R. 2025, the "Litigation Finance Transparency Act" (LFTA), introduced last Congress, and similar forced disclosure proposals. Although the legislation's intended goal of transparency is laudable, we believe that mandating automatic forced disclosure of a private litigant's financial resources will open the door to threats, intimidation, harassment, and ultimately the chilling of donor support for charitable causes and public interest organizations.

We know from experience that forced disclosure laws like that proposed by the LFTA and similar forced disclosure bills—which would mandate that parties in litigation, without a discovery request or a ruling on relevancy or privilege, disclose the details about their private financial arrangements—can easily become political weapons and bureaucratic tools for delay and harassment, restricting freedom of speech and association and eroding attorney-client privilege and other important confidentiality rules. While we support efforts to thwart abuses of our court system by bad actors, including foreign adversaries, we are concerned that the LFTA as written could too easily be used to frustrate causes that we support. It was not so long ago that IRS regulations were weaponized to stonewall, target, and discriminate against Tea Party groups, and government officials in Wisconsin used the state's "John Doe" laws in a stunning abuse of power to muzzle political opponents.

As you well know, the threat of forced disclosure chills the associational and speech rights guaranteed by the First Amendment. In recent years, we have seen an onslaught of free speech-chilling proposals, such as H.R. 1, the AMICUS Act, and the DISCLOSE Act, which would give the government unprecedented power to surveil the giving and beliefs of American citizens and the organizations with which they support and associate. In fact, two years ago, the Supreme Court struck down an attempt by California to force nonprofit organizations to disclose their donor lists because doing so violated the First Amendment. Unfortunately, we believe the proponents of this dangerous agenda would use the LFTA or similar forced disclosure provisions, if enacted, as one step down a dangerous road to silencing those with certain viewpoints – primarily conservative viewpoints.

The left and their allies would not hesitate to expand the reach of a forced disclosure law like the LFTA to attack the causes they oppose by exposing the funders of litigation brought to advance those causes. It is not hard to imagine a case where an activist judge mandates the disclosure of the identity of the funding source for a public interest lawyer challenging a college's race-based admissions policy, a discriminatory law forcing a Christian baker to participate in ceremonies that go against his religious beliefs, or a citizen challenge to government infringement of Second Amendment rights. Organizations like Citizen Power Initiatives, which is an American organization that advocates for a peaceful transition to democracy in China, already operate under the threat of reprisal by the Chinese Communist Party, and laws like LFTA would only increase those threats to not only their organization, but their personal safety.

There are many reasons why someone who donates to an organization that litigates in defense of a particular cause may wish to remain anonymous—including religious reasons, privacy, or because the cause they are supporting is considered controversial by some. LFTA's and other similar forced disclosure requirements would cause donors who might otherwise anonymously contribute to a preferred organization to not donate at all. Every American has the right to freedom of expression and association, and that includes the right to support causes in which they believe. As Attorneys General, we take seriously our duty to protect the privacy of our citizens and their right to give to charitable causes anonymously. Without this important right to association and speech, we all know that conservative causes will be the ones most targeted.

We strongly urge you to reconsider your support for the LFTA or any other form of forced disclosure. We welcome the opportunity to work with your offices to find alternative ways to improve our civil justice system while protecting the privacy of litigants.

Regards,

Steve Marshall

Steve Marshall
Alabama Attorney General

Treg Taylor
Alaska Attorney General

Raúl R. Labrador

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Alan Wilson
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Third-Party Litigation Financing in the US

by Aaron Katz, Parabellum Capital LLC, and Steven Schoenfeld, Denlea & Carton LLP, with Practical Law Litigation

Maintained • **USA (National/Federal)**

A Practice Note explaining litigation financing in the US. This Note describes how litigation financing is a mechanism by which a party not affiliated with a certain lawsuit pays for another party's (usually a plaintiff's) legal fees and costs to pursue that lawsuit, in exchange for a portion of any proceeds recovered by settlement or collection of a damages award. It is also known as alternative (or external) dispute funding.

Third-party litigation financing (also referred to as alternative or external dispute financing) is a mechanism by which a party not affiliated with a certain lawsuit pays for another party's (usually a plaintiff's) legal fees and costs to pursue that lawsuit, in exchange for a portion of the proceeds recovered by settlement or collection of a damages award.

Litigation financing is a growing industry whose US market is large (in the billions) and continuing to grow. In the US, banks, special litigation financing investment funds, **hedge funds**, and electronic marketplaces that match plaintiffs with funders have collectively invested substantial capital into this new asset class. The capital invested in litigation is categorized as uncorrelated investments because the returns are not correlated to the price movements of the stock, bond, commodity, or similar traditional capital markets.

In the current market, third-party litigation financing is primarily being used to pursue plaintiff-side or affirmative claims. This is because the metrics for success in affirmative claims are clear: if a claimant recovers cash from its adversary, then there is cash to pay the funder.

There is interest in the industry in developing ways to help companies finance their defense-side dockets as well. The model is more difficult for defense-side financing primarily because there are no affirmative litigation proceeds from which the funder can get paid. Additionally, the metric for a successful litigation outcome is inherently less clear when a defendant settles a claim or loses the lawsuit but pays less than its potential liability. Some financing companies consider **reverse contingency** arrangements, but the market for these types of products is still in the early stages of development.

This Practice Note provides an overview of third-party litigation financing for commercial litigation, including:

- How to evaluate whether litigation financing could be beneficial to a company's overall claims management (see Preliminary Considerations).
- How market forces have created a demand for litigation financing in the US (see Increasing Demand for Third-Party Litigation Financing).
- Scenarios where litigation financing may be appropriate for a corporate plaintiff (see Appropriate Situations for Third-Party Litigation Financing).
- The ethical issues raised by litigation financing (see Ethical Issues).
- How a litigation financing company assesses a claim (see Funder Considerations in Evaluating a Claim).
- The steps involved when applying for litigation financing (see Application Process for Third-Party Litigation Financing).
- The various types of financing products and pricing structures (see Litigation Financing Products, Deal Structures, and Pricing).
- The role of the funder after the investment is made (see Post-Investment Role of the Funder).

The financing of personal injury and consumer claims and **class actions** are beyond the scope of this Practice Note.

Preliminary Considerations

Litigation financing companies offer a range of financing options. To determine whether third-party litigation financing could be beneficial to a company's overall claims management, corporate counsel should:

- Evaluate the company's potential commercial claims in the US and abroad.
- Obtain estimates of related legal fees and costs of litigation.
- Consider what financing options may be appropriate, such as whether to:
    - fund the case from corporate cash flow;
    - enter into an alternative fee arrangement (AFA) with litigation counsel; or
    - combine these options.

Third-party litigation financing arrangements are complex financial transactions that must be negotiated and structured to address the unique needs of the litigant within the contours of the investment. Because litigation funders invest significant capital into a situation which inherently entails risk, they seek pricing commensurate to that risk. Therefore, in considering utilization of litigation financing, corporate counsel and executives should use the same diligence and care that they apply to any important, high-value transaction.

Increasing Demand for Third-Party Litigation Financing

Traditionally, corporate claimants have paid for legal fees and other litigation costs from corporate cash or, occasionally, through contingency fee arrangements with outside counsel (see Standard Document, Engagement (Retainer) Letter: Contingency Fee Arrangement). Generally speaking, most US corporate law firms are set up for hourly fee arrangements and are not usually suited to take on contingency fee commercial litigation.

Because corporate counsel face considerable pressure to reduce their legal expenses, they have increasingly demanded AFAs (for example, fixed or flat fees, fee caps, staged or phased fees, deferred fees) from their outside counsel to such an extent that offering at least some type of discount on or alternative to flat hourly billing has become more commonplace for many law firms (see Practice Note, Alternative Fee Arrangements).

Pressure to Reduce Legal Fees and Costs

Despite AFAs becoming more accepted, companies continue to insist that their legal departments innovate to reduce their overall legal expenses, especially in connection with litigation. One way to do that is to arrange for outside financing of the legal fees and costs to pursue affirmative claims.

Depending on the lawsuit's outcome and the particular financing arrangement, a company that uses outside financing to pursue a claim can generally limit its internal legal department expenses and use the litigation recoveries to finance the legal department budget and to pursue other corporate objectives. This arrangement, which also allows a company to spread the risk of pursuing a claim (as opposed to shouldering alone the entirety of the litigation risk), encourages legal departments to adopt the mindset of other corporate business units and pursue revenue maximization by treating meritorious legal claims as assets that can be turned into cash.

Ability to Monetize Legal Claims

Litigation financing companies in the US promote their services as a way for companies to access investment capital to fund their valuable claims. Some of a company's most valuable (although illiquid) assets are commercial claims, including claims for breach of contract, infringement of **intellectual property** rights, antitrust violations, and similar claims. Usually, a company cannot access the monetary value embedded in those claims unless it incurs the expense of what is often costly litigation. Under certain circumstances, third-party litigation financing allows corporate plaintiffs to obtain the monetary value embedded in specific claims that are otherwise too expensive to pursue due to budgetary constraints. For more information, see Practice Note, Transforming the Law Department into a Profit Center: Third-Party Litigation Financing.

Opportunity for Risk-Sharing

Third-party litigation financing is a market-based solution for corporate legal departments and the law firms they retain in a range of situations (see Appropriate Situations for Third-Party Litigation Financing). At the most general level, third-party financing facilitates fee arrangements between clients and outside counsel that might not be possible otherwise. For example, when a client needs a discount or contingent AFA that would require its trial counsel to share risk that is beyond the law firm's tolerance level or capabilities, third-party financing can allow the company to retain the firm on an alternative-fee basis. At the same time, third-party litigation financing can enable a law firm to:

- Offer its clients fee arrangements that are not strictly based on hourly billing.
- Take on additional preferable fee arrangements that are partially outcome dependent.
- Share risk cautiously while protecting itself from a total loss in the event of an adverse outcome.

Appropriate Situations for Third-Party Litigation Financing

Litigation investments are complex transactions tailored to address a company's unique situation and specific needs and objectives, such as to:

- **Pay unaffordable legal costs.** A company that cannot afford to pursue an action, or that has run out of funds during a pending litigation, may benefit from a third-party funder to defray all or part of its attorneys' fees or out-of-pocket litigation expenses (or both). These situations may include a small company with an expensive litigation investment or one in a distressed situation.
- **Use available capital for other business needs.** A company that can afford its legal fees and expenses may prefer to use its available capital for other purposes. For example, a large company may have equity or debt capital available to pursue meritorious claims but would prefer to use that available capital for attractive business opportunities (such as expansion, research and development, or talent acquisition and retention). Alternatively a company may want to apply its limited legal department budget to more urgent (and less controllable) expenses on its defense-side docket.
- **Free up embedded capital.** A company may have a case that is already underway and adequately funded, and know that the claim represents an important contingent asset that could be underwritten and monetized to free up some embedded capital for other business or legal department uses. In this situation, a funder may invest capital on a risk basis, against an agreed portion of the expected returns. This approach would be similar to a company's **securitization** of its **accounts receivable**.

In the past, companies were unable to access efficiently the value embedded in their affirmative litigation-related claims. Legal departments were generally unable to monetize claim assets through the capital markets. Often, accounting rules have prevented companies from assigning any value to claim-related assets short of pursuing them to conclusion and cash recovery in the litigation. Because companies have been historically unable to realize (or in many cases value) their legal claims as assets on their books, or to unlock the value of their claims in the marketplace, they were foreclosed from accessing potentially large amounts of capital for productive business purposes.

Third-party litigation financing helps companies unlock the value of their claim assets and transform their legal departments from cost centers into profit centers (see, for example, The Wall Street Journal: Company Lawyers Sniff Out Revenue (subscription required)). Additionally, in-house legal departments burdened by budgetary pressures are increasingly considering alternative financing as a way to manage their budgets in certain areas (see Thomson Reuters: Litigation finance as a multi-tool for corporate law departments).

Ethical Issues

Third-party litigation financing raises ethical issues that affect the funder's pre-investment evaluation of a claim and post-investment control of the litigation. These ethical issues relate to:

- Champerty and maintenance.
- The duty of confidentiality and the related **attorney-client privilege**.
- Litigation counsel's duties of loyalty and independence.

Champerty

Historically, the common law doctrine of champerty, as codified in most states, barred third parties from financially assisting a claimant in a civil suit in exchange for a portion of the monetary recovery. (For more information on concerns stemming from the ancient prohibition against strangers funding litigation, see Practice Note, Champerty, Maintenance, and Funding. For cases explaining the elements of the doctrine of champerty, see *1228 Inv. Grp., L.P. v. BWAY Corp.*, 2021 WL 3511303, at *3 (E.D. Pa. Aug. 9, 2021); *Prospect Funding Holdings, LLC v. Saulter*, 2018 IL App (1st) 171277, ¶ 28, 102 N.E.3d 741, 748; and *Frank v. TeWinkle*, 45 A.3d 434, 438-39 (Pa. Super. 2012).)

In the US, the law of champerty varies by jurisdiction and, depending on the laws of a particular state, could be an issue that corporate counsel must consider when structuring litigation financing transactions. For example, Maine requires litigation financing companies that provide funding to consumers to register with state authorities and include a representation in their dispute financing agreements that they will not control the course of the litigation (among other mandates) (9-A M.R.S.A. §§ 12-104 and 12-106). Ohio has a similar law requiring a provision on non-control (Ohio R.C. 1349.55).

Several states expressly prohibit champerty either by statute or common law, such as Delaware, Georgia, and Mississippi (see *Hall v. State,* 655 A.2d 827, 829-30 (Del. Super. Ct. 1994); O.C.G.A. § 13-8-2(a)(5); Miss. Code Ann. § 97-9-11). Also, a Pennsylvania court has held invalid an unusual attorney fee agreement with a litigation financing component based on champerty (*WFIC, LLC v. Labarre,* 148 A.3d 812, 819 (Pa. Super. 2016)). Further, the Minnesota Supreme Court abolished the common law champerty doctrine in *Maslowski v. Prospect Funding Partners LLC*, 944 N.W.2d 235, 241 (Minn. 2020).

However, some courts have relaxed champerty prohibitions on third-party litigation financing. For example, in the context of a financing arrangement with a law firm client, the Court of Appeals in New York held that "to acquire indemnification rights to the costs of past litigation" is not champerty (*Tr. For the Certificate Holders of Merrill Lynch Mortg. Invs., Inc. v. Love Funding Corp.*, 890 N.Y.S.2d 377, 384 (2009)). For more information on the *Merrill Lynch* decision, see Article, In Dispute: Love Funding.

Similarly, New York courts are generally accepting of litigation finance provided to law firms, which is often viewed as promoting adjudication of disputes on the merits (see *Hamilton Cap. VII, LLC, v. Khorrami, LLP*, 22 N.Y.S.3d 137, at *5-6 (Sup. Ct. N.Y. Co. 2015) (noting that alternative litigation finance furthers the policy of favoring that cases be decided on their merits instead of based on the greater financial resources of one party and holding that financing of law firm did not violate a prohibition on lawyer splitting fee with non-lawyer or restrictions on usury); *Lawsuit Funding LLC v. Lessoff*, 2013 WL 6409971, at *6 (Sup. Ct. N.Y. Co. Dec. 4, 2013)).

New York's champerty prohibition can apply in extreme and atypical scenarios. For example, in *Justinian Cap. v. WestLB AG*, the real party in interest sought to pursue claims based on notes it had acquired but did not want to appear as a plaintiff for political reasons. Accordingly, the real party in interest assigned its claims to an unrelated third party for the principal purpose of filing suit. The third party agreed to pay a purchase price of $1,000,000 for the assignment, and to remit the majority of claim proceeds back to the real party in interest. The court found the arrangement champertous "because the notes were acquired for the sole purpose of bringing litigation." Moreover, even though New York's champerty statute has a safe harbor for purchases and assignments of notes with an aggregate purchase price of at least $500,000 (N.Y. Jud. Law § 489(2)), the court held that the safe harbor did not apply because the plaintiff had not actually paid the purchase price to the assignor. (43 N.Y.S.3d 218, 222 (2016).)

Additional examples of relaxed champerty restrictions on third-party litigation financing are identified below:

- Delaware (*Charge Injection Techs., Inc. v. E.I. Dupont De Nemours & Co.*, 2016 WL 937400, at *4 (Del. Super. Ct. Mar. 9, 2016)).
- Florida (*Kraft v. Mason,* 668 So. 2d 679, 683 (Fla. 4th DCA 1996)).
- Texas (*Anglo-Dutch Petroleum Int'l v. Haskell,* 193 S.W.3d 87, 104-05 (Tex. App.—Houston [1st Dist.] 2006, pet. denied)).
- Massachusetts (*Saladini v. Righellis,* 687 N.E.2d 1224, 1226 (Mass. 1997)).
- South Carolina (*Osprey, Inc. v. Cabana Ltd. P'ship,* 532 S.E.2d 269, 277-78 (S.C. 2000)).
- Illinois (*Miller UK Ltd. v. Caterpillar, Inc.,* 17 F. Supp. 3d 711, 725-26 (N.D. Ill. 2014)).

In most states today, because champerty is either now outright abolished or narrowly defined, it can usually be avoided by properly structuring the investment and limiting the funder's influence on the litigation (see Practice Note, Third-Party Litigation Financing: Ethical Issues for Attorneys and American Bar Association Commission on Ethics 20/20 White Paper on Alternative Litigation Finance).

Client Confidentiality and the Attorney-Client Privilege

When evaluating a prospective investment in a claim, a funder must conduct **due diligence** on the parties and their claims and defenses. After making an investment, the funder will want to monitor it, including the progress of the litigation and any conclusion that results in the collection of proceeds to which the funder may be partially entitled. A funder may look at public information on potential claims (such as pleadings) if the litigation has already commenced. However, a funder may want additional information from the claimant and its litigation counsel, especially before committing to an investment in a lawsuit.

Risk of Waiver

Attorneys have an ethical duty to preserve a client's confidential information and must not disclose information to a third-party funder without explaining the risks of doing so to the client and obtaining the client's informed consent (American Bar Association Model Rules of Professional Conduct (ABA Model Rules) Rule 1.6(a)). The principal risk is that sharing information with a third-party litigation funder might waive the attorney-client privilege and, although less likely, **work product protection**. These waivers could:

- Subject privileged information to discovery by the adverse party.
- Damage the claimant's case (and consequently the funder's investment).

For example, in *Leader Techs., Inc. v. Facebook, Inc.*, the court compelled disclosure in discovery of documents shared with financing companies during discussions about potential financing, rejecting the argument that the documents were protected by the common interest exception to the waiver of the attorney-client privilege (719 F. Supp. 2d 373, 376-77 (D. Del. 2010); see also *In re Dealer Mgmt. Sys. Antitrust Litig.*, 335 F.R.D. 510, 514 (N.D. Ill. 2020). The National Law Journal: Litigation Funders Face Discovery Woes (subscription required)).

However, courts have held that disclosure to prospective investors of documents reflecting the plaintiff's litigation strategy did not waive the work product protection (*Mondis Tech. Ltd. v. LG Elecs., Inc.,* 2011 WL 1714304, at *3 (E.D. Tex. May 4, 2011); *Viamedia, Inc. v. Comcast Corp.*, 2017 WL 2834535, at *3 (N.D. Ill. Jun. 30, 2017) (finding that due diligence documents shared between claimant and litigation funder did not waive the work product doctrine because it did not make it more likely that the information would fall into the hands of the defendants)).

A bankruptcy court also held that the work product doctrine protected from discovery certain parts of the dispute funding agreement and opinion-related communications between the client, the client's attorney, and the funder (*In re Int'l Oil Trading Co., LLC*, 548 B.R. 825, 832 (Bankr. S.D. Fla. 2016)). Also, courts have found that information shared with an investor under controlled conditions and as part of a confidentiality, common interest, and non-disclosure agreement is protected by both the attorney-client privilege and the work product doctrine (*Devon IT, Inc. v IBM Corp.,* 2012 WL 4748160 (E.D. Pa. Sept. 27, 2012); *Doe v. Soc'y of Missionaries of Sacred Heart et al.*, 2014 WL 1715376, at *3-4 (N.D. Ill. May 1, 2014)).

Another federal court held that regardless of what a party intended to hold, it could not "trump the Seventh Circuit's decision in *BDO Seidman*, see *U.S. v. Watson*, 87 F.3d 927, 930 n. 2 (7th Cir.1996), or the admitted "host of case law that provides" that the shared interest must be legal. (Miller Memorandum at 10)." (*Miller UK Ltd. v. Caterpillar, Inc.*, 17 F. Supp. 3d 711, 734 (N.D. Ill. 2014).)

On April 3, 2018, Wisconsin enacted a new statute requiring the disclosure of third-party dispute funding agreements in civil actions filed in state court. Under the new statute, "a party shall, 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, by settlement, judgment, or otherwise." (Wis. Stat. § 804.01(2)(bg).)

However, Section 804.01 does not address the potentially privileged nature of certain terms within funding agreements (for example, economic terms) that may reveal risk assessment in the nature of mental impressions and opinions of litigation that several courts have found are protected by the work product doctrine and can be redacted (for example, *In re: Int'l Oil Trading Co.*, 548 B.R. at 839 (citing *Carlyle Inv. Mgmt. LLC v. Moonmouth Co.*, 2015 WL 778846 (Del. Ch. 2015); *Charge Injection Techs., Inc. v. E.I. DuPont De Nemours & Co.*, 2015 WL 1540520 (Del. Super. Ct. 2015)) (permitting the redaction of terms, including payment terms in a funding agreement, to prevent disclosure of attorney mental impressions and opinions)).

Even if a litigation funding agreement is produced in discovery, a court may exclude the evidence at trial for lack of relevance or risk of prejudice (or both) under Federal Rule of Evidence 403 (see *AVM Techs., LLC v. Intel Corp.*, 2017 WL 1787562, at *3 (D. Del. May 1, 2017)).

At the federal level, no Federal Rule of Civil Procedure mandates the automatic disclosure of funding arrangements. Approximately half of federal circuit courts and a quarter of federal district courts require the disclosure of outside parties with a financial interest in the outcome of a litigation. The purpose of that disclosure is usually to avoid judicial conflicts of interests. (5th Cir. L. R. 28.2.1; C.D. Cal. L.R. 7.1-1.) However, one court, the District of New Jersey, enacted a local rule in 2021 mandating the disclosure of non-parties with a contingent interest in a litigation. In addition to the identity of the non-party, this local rule requires that a plaintiff state whether the non-party has approval rights related to litigation or settlement decisions, and describe the nature of the contingent interest. (D.N.J. L.Civ.R. 7.1.1.) Additionally, the Central District of California requires parties to disclose persons or entities with a financial interest in the proceeding or other interest that could be substantially affected by the outcome of the litigation. (N.D. Cal. L. R. 3-15.) Further, within the District of Delaware, a standing order for cases assigned to Chief Judge Colm F. Connolly largely mirrors the disclosure rule in the District of New Jersey, discussed above.

Claim Evaluation with Limited, Non-Privileged Information

Because the consequences of waiving privilege are detrimental to both the claimant and the funder, they have a mutual interest in avoiding a privilege waiver. Therefore, they must tread carefully when exchanging information about the claimant's case. It is advisable to execute an appropriate confidentiality and nondisclosure agreement to protect confidentiality and guard against the waiver of applicable privileges and protections attaching to the information to be shared with a funder.

Although concerns about waiver may limit a funder's ability to conduct due diligence and increase the risk of the funder's investment, usually these concerns do not prevent the funder from obtaining sufficient information to evaluate a prospective investment in a claim. This is similar to attorneys who work on a contingency fee basis and routinely determine whether a litigation is worthy of investment despite incomplete or uncertain information.

In any event, the claimant may disclose the underlying documents and other information that:

- Are not privileged.
- It reasonably expects will be disclosed to the adverse party during discovery in the litigation.

Using that information and other data it may collect, the funder can assess the claim.

After the funder makes an investment, the claimant's litigation counsel may report on developments in the case that are either publicly available or already disclosed to the adverse party, subject to any **protective order** or other confidentiality limits. Usually, this type of information is enough to allow the funder to monitor the litigation, without compromising the claimant's attorney-client privilege.

Counsel's Duty of Loyalty and Independence

Litigation counsel owes its client a duty of loyalty, which requires it to act in the client's best interests and give the client independent legal advice without interference from third parties, even if a third party pays the attorney (ABA Model Rule 1.7). An attorney cannot serve parties with conflicting interests (ABA Model Rules 1.7, 1.8(f), and 5.4(c)). However, an attorney may have an interest in the outcome of a civil case because an attorney may contract with a client for a reasonable contingency fee (ABA Model Rule 1.8(i)(2)).

Ethical duties of loyalty and independence play a critical role in third-party litigation financing. For example, a third party with an interest in the outcome of the claimant's litigation may be financing litigation counsel's legal fees and costs directly or indirectly through the claimant. Insurers play a similar role in providing litigation financing for defendants. Insurance companies usually contract for the right to be involved in the defense and settlement of a case subject to acting in good faith and respecting the interests of the insured.

In contrast to insurers, litigation funders avoid that level of involvement. A third-party funder who controls the litigation might violate counsel's ethical duties of loyalty and independence in addition to champerty laws (see Champerty), which is why funders disclaim control in their investment documents. Therefore, third-party funders do not:

- Hire or terminate litigation counsel.
- Direct litigation strategy.
- Make settlement decisions.

A Florida state appeals court concluded that a funder who controlled the litigation in these ways rose to the level of a party to the lawsuit and therefore was liable for the defendant's attorneys' fees and costs (*Abu-Ghazaleh v. Chaul,* 36 So. 3d 691, 693-94 (Fla. 3d DCA 2009); see also *Miccosukee Tribe of Indians of S. Fla. v. Bermudez*, 145 So. 3d 157, 160 (Fla. 3d DCA 2014)). However, funders of commercial claims usually do not try to exercise this amount of control over the litigation. (Also see *Backertop Licensing LLC, et al. v. Canary Connect, Inc.*, Case No. 23-2367 (Fed. Cir. 2024), affirming civil contempt order against LLC owner/non-party witness arising from non-compliance with a district court's *sua sponte* order to attend an in-person hearing the court set in connection with its investigation into whether the party and its counsel violated local disclosure rules by failing to disclose potential litigation funding, another non-party committed fraud on the court by concealing the real parties in interest, and counsel violated the Rules of Professional Conduct by taking direction from a non-legal consulting firm without the informed consent of the plaintiff.)

Funder Considerations in Evaluating a Claim

A litigation financing company evaluating a claim for potential investment analyzes issues relating to:

- Adverse risk selection and moral hazard.

- The merits of the claim and potential damages available.
- Possible obstacles to collecting damages.
- Reasons to decline a funding opportunity unrelated to the merits of the claim or collection risks.

Adverse Risk Selection and Moral Hazard

A funder faces two significant structural challenges when evaluating a claim for potential funding:

- Adverse risk selection.
- Moral hazard.

The funder must be cognizant of the possibility that it is potentially being approached by a corporate claimant that seeks third-party funding only for matters with the highest risk profile and the lowest chance of success while self-funding its less risky litigation. Frequently, the funder is at an informational disadvantage because the claimant cannot share important case information due to privilege or other restrictions, such as court-ordered confidentiality. This information asymmetry makes it especially difficult for the funder to evaluate fully the risks of specific cases. As a result, a funder is often at risk of ending up burdened with excessively risky lawsuits.

The funder also faces the possibility of moral hazard, by which the litigation counsel or the claimant (or both) can behave in a way that is detrimental to the funder after the financing transaction has closed and the funding arrangement is in place.

Therefore, while the funder's investment itself reduces the client's risk and investment of resources (and if not structured properly could in theory disincentivize the client from making the best litigation or settlement decisions), the funder cannot protect itself by controlling those decisions. In effect, the funder faces the challenge of deploying significant capital into a lawsuit that could have a high-risk profile. The possibility of moral hazard on the part of the claimant and its litigation counsel is usually addressed in the funder's pricing of its investment and in the way the investment is structured, which should be tailored to incentivize rational economic decision-making by the claimant and counsel at all stages of the litigation.

The funder is a passive investor, and in general, between a client and its attorney, the client has the sole authority to decide whether to settle a civil lawsuit (ABA Model Rule 1.2(a)). This is inherent in the fiduciary nature of the attorney-client relationship.

Aligning Incentives

To overcome the challenges of adverse risk selection and moral hazard, the interests of the claimant, its litigation counsel, and the funder must be aligned. The funder compensates for its lack of information and control by structuring the transaction to ensure that all of the parties have the same incentives. Accomplishing this generally requires true risk sharing. The claimant and its litigation counsel must be at risk of meaningful loss alongside the funder. However, in many situations the funder is more insistent that litigation counsel share the risk than that the claimant do so. This is because litigation counsel is often a better judge of the risk than the claimant itself, and litigation counsel's role is usually critical in determining the dispute's outcome.

Litigation counsel's time and budget has a substantial embedded profit margin. This makes the funder's and litigation counsel's respective investments unequal so that designing a risk-aligned transaction with litigation counsel is often imperfect. Therefore, the funder seeks to structure a transaction in which the funder and litigation counsel are investing and sharing risk in a parallel fashion, with the funder investing alongside litigation counsel as each incremental dollar is spent on fees or disbursements in the case. This way the funder knows that litigation counsel is putting at least some of the law firm's resources (principally, the investment of billable attorney time) at risk as the case proceeds.

Usually, specific arrangements are individually negotiated and dependent on other terms, such as fee caps where the attorney's total paid fee apart from a contingent component is limited to a certain amount. As an example, the funder or the claimant may negotiate a reduced billing rate with litigation counsel (such as 60% of counsel's standard rate). When the claimant is either awarded damages or settles the case for a favorable amount, the percentage of fees that was deferred during the litigation (in this example, 40%) is paid to litigation counsel on recovery after the funder has been paid. Moreover, the claimant's agreement with its litigation counsel would likely include a provision to pay counsel a contingent bonus or kicker tied to a metric for success regarding the proceeds recovered. Although this may not guarantee a perfect alignment of interests (or guarantee a successful outcome), if properly done and carefully underwritten, this type of deal structure can help ensure that interests are sufficiently aligned to protect the funder against true adverse risk selection.

Merits of the Claim and Potential Damages

To conduct adequate due diligence and underwrite a litigation financing transaction, the funder tries to understand the claim's risks as much as possible, despite the funder's likely inability to obtain full and complete case information. Understanding risk includes analyzing the merits of the legal claims and the potential damages. The funder also tries to understand:

- How long the matter is likely to last.
- The nature of the parties and their litigation counsel.
- Any ethical or regulatory concerns that may arise.

An important consideration is whether the outcome of the case can turn based on a single factual finding or legal conclusion by the jury or court, or additional risks that the financing transaction's structure cannot address (for example, unusual collection risks such as recoveries that depend on pursuing foreign assets). The funder tries to avoid these risks and, if it accepts them, prices the investment appropriately by increasing its prospective share of any settlement or damages award.

Possible Obstacles to Recovering Damages

An important consideration in a funder's analysis is whether the client will be able to collect its award if the litigation is successful. If available assets are not readily identifiable, independent investigation or discovery may be required.

Collection efforts occasionally involve pursuing assets both in the US and abroad, possibly in multiple foreign jurisdictions. This can involve substantial expense and added legal risk, as collection may require expertise in the laws and procedures of multiple foreign jurisdictions. In some instances, the corporate structure of the defendant may require reliance on a veil-piercing or other theory that permits direct access to the assets of a related entity that is better able to satisfy the judgment. The creditworthiness of the defendant also can be an issue when the defendant (possibly because of the judgment itself) is at risk of insolvency. Finally, political considerations within a given country might hinder a US entity's ability to collect from a local concern.

Reasons a Funder May Reject a Claim

A funder may decline a funding opportunity for reasons unrelated to the particular merits of the case or the risks of collection. For example, the dispute may implicate domestic or international political issues that entail risks or uncertainties that the funder does not want to bear. In other circumstances, the case may relate to sensitive or controversial subject matter with which the investor does not want to be associated. Additionally, a funder may pass on a particular opportunity for portfolio management or risk concentration reasons (for example, the funder already has exposure to similar litigation) or because the matter does not align with the funder's investment mandate.

Application Process for Third-Party Litigation Financing

Although most litigation financing arrangements are heavily negotiated and customized transactions, the funding process usually involves some or all of the following basic steps:

- Preparing for the funder's assessment of the claim.
- Conducting due diligence for the funder's initial evaluation of the claim.
- Executing the financing agreement.

Preparing for Assessment

As part of the traditional, early case assessment process, a claimant should consider whether the claim should be pursued. This analysis may include:

- Identifying and reviewing key documents and witnesses.
- Analyzing legal theories.
- Assessing potential monetary recoveries.

For additional issues that plaintiff's counsel should consider before commencing a lawsuit in federal district court, see Practice Note, Commencing a Federal Lawsuit: Initial Considerations.

If the claimant decides to pursue third-party litigation financing, it should prepare relevant case materials for the funder, but only after consulting litigation counsel to avoid sharing any materials that may implicate a waiver of privilege or breach of confidentiality (see Client Confidentiality and the Attorney-Client Privilege). In the ordinary course, sensitive non-public information should not be shared with a funder without first executing an appropriate nondisclosure agreement which preserves confidentiality and applicable privileges and protections.

Examples of potentially relevant case materials include:

- Primary documents relied on in the case (for example, the operative contract).
- Likely evidence (such as correspondence and witness statements).
- Key court documents filed in an already pending case.
- Non-privileged documents analyzing and supporting the legal claims and the damages sought.

Additionally, the claimant should provide the funder with an estimated budget for legal fees and expenses, preferably broken down into the various expected stages of the litigation. For a monthly litigation budget template for estimating or calculating projected or actual legal fees and expenses, see Standard Document, Litigation Budget Template. For a flowchart that can help calculate the costs of litigating throughout a case's various stages see Case Assessment Decision Tree and Costs Worksheet.

Initial Evaluation

The funder's evaluation process usually begins with a confidential meeting or conversation in which the claimant or its litigation counsel describes the matter generally, and the funder describes its products and potential funding solutions. If this initial discussion confirms their mutual interest, the parties execute a formal confidentiality agreement to facilitate more in-depth discussions.

The confidentiality agreement is mutual. The funder agrees to keep confidential any information or materials provided by the claimant, and the claimant agrees to keep confidential any information regarding the funder's proprietary products and process. However, all parties must bear in mind that the confidentiality agreement may not shield the communications between the funder and the claimant (and the claimant's litigation counsel) from discovery in litigation. For more information on confidentiality agreements, see Standard Document, Confidentiality Agreement: General (Mutual).

Term Sheet

After the initial confidential meeting, the client provides case-related information and documentation to the funder. During one or more conversations or meetings, the funder and the claimant (and frequently, the claimant's litigation counsel) discuss the claims and the parties' proposed economic terms for the transaction.

If the funder's initial evaluation of the case suggests that it makes sense to develop a transaction, and the funder and the claimant can agree on initial economic terms, the parties execute a non-binding **term sheet**. Although this term sheet outlines the parties' understanding of the parameters of a potential transaction, it is understood at this stage that the terms of the potential transaction may require adjustment based on the funder's evolving evaluation of the case following more extensive due diligence.

Underwriting Due Diligence and Investment Decision

After the term sheet is executed, the funder conducts a deep dive into the matter's legal and factual issues. This includes analyzing the claim's legal merits and potential damages, as well as several other important factors that vary from case to case, such as:

- The nature of the parties and their litigation counsel.
- The likely amount of time before resolution.
- Settlement prospects.
- The collection risks.
- The nature of the court or forum.
- Any unique ethical considerations or reputational issues.

A funder's simple due diligence checklist typically touches on the following issues:

- **Merits of the case.** What are the strengths and weaknesses of the legal arguments the claimant will make? What are the strengths and weaknesses of the supporting evidence? What arguments and evidence will the opposing party use in defense? What legal precedent applies with respect to parties' arguments?
- **Damages.** What is the proper measure of damages for the claims asserted? How likely is it that the claimant can prove its damages at trial? What level of damages might the claimant achieve in settlement?
- **Collection.** Is the defendant financially able to pay a judgment? If not, are other payment sources available, such as from the defendant's liability insurance? Will collection require additional investigation or litigation?
- **Duration.** How long will it take for the case to reach a final resolution, including any appeal?
- **Legal fees and costs.** What are the estimated legal fees and costs for the case?

For more information on estimating the cost of litigation, see Practice Note, Commencing a Federal Lawsuit: Initial Considerations.

Potential investments typically go through a vetting process after due diligence is complete. For example, an underwriting or investment committee or similar group may review the due diligence information and will either reject or approve the financing, subject to certain conditions and final documentation.

Executing the Financing Agreement

If the funder's underwriting criteria are met and the parties come to a final agreement on economic terms, the parties execute a definitive financing agreement. Because litigation counsel may have a stake in the agreement's terms, clients who do not have in-house counsel may wish to consider having independent outside counsel not involved with the case negotiate and review these agreements. Increasingly there are practitioners who specialize in advising claimants in connection with entering funding agreements, and reliance upon counsel with this particularized expertise can be cost effective and promote efficiency in papering the funding transaction. Also, where court approval of the transaction may be required, the agreement terms should account for any additional considerations imposed by the judge, such as that the terms of the financing be economically reasonable under the circumstances (see *Forsythe v. ESC Fund Mgmt. Co.,* 2013 WL 458373, at *4 (Del. Ch. Feb. 6, 2013)).

Litigation Financing Products, Deal Structures, and Pricing

Most third-party litigation financing in the commercial claims segment of the market focuses on large, business-to-business litigation and arbitration across the full range of commercial disputes, such as:

- Breach of contract.
- Antitrust violations.
- Trade secret, copyright, and patent infringement.
- Cross-border investment disputes and other international arbitration claims.
- Joint venture or non-class shareholder disputes.

A transaction in this market segment may require the funder to invest between $1,000,000 and $15 million, or far more, to fund the litigation (this segment does not include personal injury or consumer class actions).

Types of Products

There is substantial creativity in the litigation financing community, and often funders seek to explore and develop transactions for cases or programs across a wide range of products and deal types. Generally, funders provide the following types of products for the commercial claims market segment:

- **Early-stage funding.** In this situation, attorneys' fees and case disbursements are borne by a combination of the litigation counsel, funder, and claimant. From the claimant's perspective, this product looks like a contingency fee arrangement. However, instead of litigation counsel handling the matter on a full contingency fee basis, it pursues it on a partial contingency fee basis with the funder making up all or most of the balance.
- **Claim monetization.** In this case, funds are used for general company purposes, rather than for prosecuting the litigation. This is used where the claimant, often a corporate entity, has the litigation fees and costs covered but desires liquidity for other business uses. The funder provides the amount of the monetization at closing and receives its return

from any proceeds recovered on the claim. Claim monetization allows a claimant to immediately realize value from ongoing litigation.

- **Funding case disbursements or out-of-pocket expenses.** This type of funding is applicable for early- or later-stage cases when litigation counsel has accepted the case on a contingency fee basis but counsel (or the claimant) cannot or prefers not to fund disbursements or out-of-pocket costs. Using third-party financing in this situation allows litigation counsel to simply invest time, rather than cash.

- **Appeals hedging or monetization.** For judgments on appeal (or verdicts in post-trial proceedings), the funder provides liquidity or a simple guarantee of a portion of the judgment amount.

- **Law firm portfolio financing.** This is a direct funding to a law firm, whereby a funder advances money to help fund a pool of contingency cases in exchange for a fixed return at a specified waterfall of recovery. The funder's investment is non-recourse and can be recovered only out of the agreed pool of contingency cases. This arrangement allows a law firm to share risk and take on more contingency cases.

Programmatic Solutions and Non-Cash Receivables

Generally, funders in the commercial claims market segment are underwriting and investing in individual, large affirmative cases. However, financing is also available for programmatic recovery operations. Rather than focusing on one-off, individual situations, a funder might engage in a longer-term relationship with a counterparty, providing financing for a range of related matters.

One prime example is an intellectual property enforcement program against numerous targets (or other recurring types of claims) that may be individually small but substantial in the aggregate. In these situations, the principal relief typically sought is cash, although there are valuation mechanisms possible where the principal relief is a business solution rather than monetary damages. The funder usually negotiates an investment return consisting of a cash payment paid to the funder when individual cases in the program resolve or which is paid based on the resolution of a group of cases. Transaction documents generally include a mechanism for valuing any non-cash assets (for example, cross-licenses or contractual concessions by the adverse party) recovered by the client.

Although forward-running royalties in intellectual property cases may be substantial, funders may prefer a preset payout mechanism instead of participation in a future revenue stream. Nonetheless, if the business opportunity looks attractive, large, sophisticated funders may be willing to be paid out over time or carry a non-cash asset. It may also be possible to monetize the future payment stream through a financial institution, such as an investment bank.

Additionally, an investor may be able to provide solutions to assist a client with post-judgment enforcement and collection efforts, such as:

- Financing a collateral collection action.

- Monetizing a portion of the judgment.

- Hedging some of the collection risk.

Pricing

Third-party litigation financing agreements are individually negotiated transaction deals that must be structured according to the unique facts and circumstances relating to each case. Pricing is an important part of these negotiations because it reflects the degree of risk the funder assumes. Pricing terms, for example, depend heavily on the parties' assessments of the potential recovery available despite the risks presented. A funder's analysis of the risk of loss may include a variety of factors, such as:

- The strength of the claim.

- The amount to be invested.
- The duration of the investment.
- The potential collection risks.

Multiple financing companies may weigh pricing and risk factors differently and therefore may each provide varying pricing structures for the same or similar opportunities. For example, different pricing factors may come into play when the funder and claimant have an existing relationship, or when the claimant's litigation counsel has a specialized skill set or reputation regarding the claim's subject matter, or where a funder perceives the risks associated with the litigation differently from the perception of others in the marketplace. Therefore, pricing and returns vary, sometimes widely, based on:

- The characteristics of the individual claim.
- The due diligence and analysis of the funder and the claimant.
- The bargaining process between the funder and the claimant.

In light of these highly individualized and case-specific factors, it is not useful to look to typical or average pricing across the dispute financing industry, or even across specific market segments or product types. Calculating an average pricing range is more difficult because investors have many ways of pricing transactions. For example, the return may be a multiple of invested capital or a percentage of the recovery (or some combination of the two), or the return may be calculated as a specific internal rate of return on the invested capital. In some unusual circumstances, it may be appropriate to use a different metric entirely. For example, if the funded litigation enables the client to achieve an injunctive, transactional, or other strategic objective, the pricing might reflect some of the new business value that has been created, although not specifically based on the metrics described above.

Post-Investment Role of the Funder

After the financing transaction is closed, the funder monitors developments in the case as it progresses until the matter is finally resolved. Because the funder must continue to be vigilant regarding privilege and confidentiality limitations, its monitoring is usually limited to:

- Examining publicly available case filings (which sometimes may be unavailable or redacted due to protective orders).
- Receiving reports from the claimant and its litigation counsel that comply with any applicable restrictions.
- Reviewing documents not subject to privilege or otherwise protected by a confidentiality agreement between the claimant and the defendant.

It can take years for a case to reach a resolution. If the case is resolved favorably, the funder is entitled to payment according to the financing agreement. Depending on the financing agreement, payment may be made or secured through cash, **securities**, **liens**, **escrow** accounts, or a combination of these.

ARC
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CONSUMER LEGAL FUNDING
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The following comments are submitted on behalf of The Alliance for Responsible Consumer Legal Funding (ARC) to the SCAC Subcommittee.

ARC is the largest Trade Association that represents companies that provide Consumer Legal Funding across the country and in Texas.

As you are reviewing the issue of Third-Party Litigation Financing (TPLF) we hope that you will take into consideration the vast differences between Litigation Financing and Consumer Legal Funding as they are not the same.

Consumer Legal Funding covers living expenses, such as rent, food, clothes and keeping the lights on. It might even enable a family to provide Christmas or birthday gifts for their children. In every case, its sole purpose is to help individuals and families alleviate the cash-flow problems that arise in the wake of an accident or other tragic circumstances, while the individuals and families are seeking compensation for their situation. It has nothing to do with financing of the litigation.

Where Litigation Financing is just that, it finances the cost of the litigation. The funds provided are used to cover the cost of the attorney, deposition cost, court cost and any other associated expenses to bring a case forward.

Consumer Legal Funding is nothing like that, it helps a consumer meet their financial obligations while their legal claim is making its way through the justice system. It does not pay for deposition cost. It does not pay for legal fees or expenses.

Most of the time the funds go to help a consumer who has had a car accident bridge the financial gap, but there are other times where it goes to help a person who was wrongfully convicted and spent nearly two decades of their life in prison for a crime they did not commit. Consumer legal funding helped them get their life back by assisting with living expenses while they got the justice they so justly deserved.

Here some other examples:

- It helped a Police Officer pay to keep a roof over their family's head while they had their day in court after being wrongfully discharged.

- Then there is the case of a single mother of three who was going back to college to make a better life for her children and had to move out of their home because of a toxic mold infestation. She used consumer legal funding to pay for a mobile home so she and her three children could live in a safe, toxic-free, environment while the situation was fixed.

- Another example is when a 16-year-old was made a quadriplegic due to medical negligence. The family had to modify their home to make accommodations to care for their loved one. Consumer legal funding was the only way they were able to take care of their teenager while the case made its way through the long legal system.

- Another was a woman was involved in a car accident and her teeth were shattered because of the accident. She used consumer legal funding to get a new set of teeth. She said, "it gave me my smile back".

- Finally, there have been times where consumer legal funding was used to help pay for funeral expenses of a loved one that was tragically killed in an accident. Sadly, some families had no other means of taking their loved one to their final resting place if it had not been for consumer legal funding.

The issues that have been brought up in the media and by those who what disclosure on TPLF are not distinguishing between Consumer Legal Funding and Litigation Financing. We respectfully ask that if the focus disclosure is the funds used to bring litigation forward that when you define the term "Litigation Finance" or "Third-Party Litigation Financing" that you clearly define it as the funds used to fund the actual litigation and funds used to ensure a consumer can provide food or keep a roof over their families head while their case is making its way through the legal system.

If we may make some recommendations as to how to define the term "Litigation Financing"

The following are from statutes that were introduced into legislation in 2024

From Florida HB 1179:

> *"Litigation financing" means a transaction in which a litigation financier agrees to provide financing to a person who is a party to or counsel of record for a civil action, administrative proceeding, claim, or other legal proceeding in exchange for a right to receive payment, which right is contingent in any respect on the outcome of such action, claim, or proceeding or on the outcome of any matter within a portfolio that includes such action, claim, or proceeding and involves the same counsel or affiliated counsel. However, the terms do not apply to:*
>
> *(a) An agreement wherein funds are provided for or to a party to a civil action, administrative proceeding, claim, or other legal proceeding for such person's use in paying his or her costs of living or other personal or familial expenses during the pendency of such action, claim, or proceeding and where such funds are not used to finance any litigation or other legal costs.*

> *(b) An agreement wherein an attorney consents to provide legal services on a contingency fee basis or to advance his or her client's legal costs, and where such services or costs are provided by the attorney in accordance with the Florida Rules of Professional Conduct.*
>
> *(c) An entity with a preexisting contractual obligation to indemnify or defend a party to a civil action, administrative proceeding, claim, or other legal proceeding.*

From Kansas HB 2510

> *Third-party agreements. A party may obtain discovery of the existence and content of any third-party agreement under which any person, other than an attorney representing a party, has agreed to pay expenses directly related to prosecuting the legal claim and has a contractual right to receive compensation that is contingent on and sourced from any proceeds. Information concerning the third-party agreement is not, by reason of disclosure, admissible as evidence at trial.*

From Louisiana HB 336:

> *(a) "Litigation financing" means the financing, funding, advancing, or loaning of money to pay for fees, costs, expenses, or an agreement to pay expenses directly related to pursuing the legal claim, administrative proceeding, claim, or cause of action if the financing, funding, advancing, or loaning of money is provided by any person other than a person who is any of the following:*
>
> > *(i) A party to the civil action, administrative proceeding, claim, or cause of action.*
> >
> > *(ii) An attorney engaged directly or indirectly through another legal representative to represent a party in the civil action, administrative proceeding, claim, or cause of action.*
> >
> > *(iii) An entity or insurer with a preexisting contractual obligation to indemnify or defend a party to the civil action, administrative proceeding, claim, or cause of action or a health insurer which has paid, or is obligated to pay, any sums for health care for an injured person under the terms of any health insurance plan or agreement.*
>
> *(b) Funds provided directly to a party solely for personal needs shall not be considered litigation financing if such funds are provided exclusively for personal and family use and not for legal filings, legal document preparation and drafting, appeals, creation of a litigation strategy, drafting testimony, and related litigation expenses.*

As you can see in each of these examples it is clear that the funds provided to a consumer for household and living expenses are not subject to definition of “Litigation Financing”.

In fact, states that have passed legislation to regulate Consumer Legal Funding funds, such as Oklahoma, prohibit the funds to be used for “Litigation Financing”.

From the Oklahoma Statute (Enrolled Senate Bill SB 1016 enacted in 2013) under Prohibited acts:

> *Knowingly pay or offer to pay, using funds from the litigation funding transaction, court costs, filing fees, or attorneys' fees during or after the resolution of the legal claim.*

Another issue that has been raised regarding Third-Party Litigation Financing is that funders can exercise control over the case. In a recent publication it was stated:

> *Funders frequently exert significant control over the litigation process, including strategic decisions and settlement negotiations, which can undermine the interests of the actual parties involved.*

This again is not the case regarding Consumer Legal Funding. In statutes that have been enacted, like in Oklahoma, it is strictly prohibited, again from the enrolled SB 1016 under Prohibited acts:

> *Make a decision relating to the conduct, settlement, or resolution of the underlying legal claim, the power of which shall remain solely with the consumer and the attorney handling the legal claim;*

This point is also emphasized in our Associations Best Practices which are based on the American Bar Association 2020 Best Practices for Third-Party Litigation Funding and consumer litigation funding industry standards that each member must abide by:

- Each member agrees the funding agreement will be structured so that the consumer, not the funder, retains the right to control the conduct and litigation of their claim.

Finally, the biggest difference between Consumer Legal Funding and Litigation Financing is the amount of funds provided. On average in Consumer Legal Funding the amount of funds provided to a consumer is typically $3,000 to $5,000. Where in Litigation Financing the typical minimum is $3,000,000.

We respectfully request that when the committee is looking at the issue of Third-Party Litigation Financing and if the product/s should be disclosed or regulated that you take into consideration the vast differences between Litigation Financing and Consumer Legal Funding and have a clear definition of what it is you are regulating.

We thank you for your consideration and feel free to contact our President Eric Schuller at eschuller@arclegalfunding.org if you have any questions.

On behalf of our members

Eric Schuller

Eric Schuller
President

DEEPFAKES IN COURT: HOW JUDGES CAN PROACTIVELY MANAGE ALLEGED AI-GENERATED MATERIAL IN NATIONAL SECURITY CASES

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ABSTRACT

Dall-E. ChatGPT. GPT-4. Words that did not exist in the English lexicon just a few years ago are now commonplace. With the widespread availability of Artificial Intelligence (AI) tools, specifically Generative AI, whether in the context of text, audio, video, imagery, or even combinations of these, it is inevitable that trials related to national security will involve evidentiary issues raised by Generative AI. We must confront two possibilities: first, that evidence presented is AI generated and not real and, second, that other evidence is genuine but alleged to be fabricated. Technologies designed to detect AI generated content have proven to be unreliable,[2] and also biased.[3] Humans have also proven to be poor judges of whether a digital artifact is real or fake.[4]There is no foolproof way today to classify text, audio, video, or images as authentic or AI generated, especially as adversaries continually

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[2] See Momina Masood, Mariam Nawaz, Khalid Mahmood Malik, Ali Javed, Aun Irtaza, & Hafiz Malik, "Deepfakes Generation and Detection: State-of-the-Art, Open Challenges, Countermeasures, and Way Forward," APPLIED INTELLIGENCE 53 (June 2023): 3984–3985.

[3] See Ying Xu, Philipp Terhörst, Kiran Raja, & Marius Pedersen, "A Comprehensive Analysis of AI Biases in DeepFake Detection with Massively Annotated Databases" (Preprint, submitted in 2022), 1, https://arxiv.org/abs/2208.05845.

[4] Nils C. Köbis, Barbora Doležalová, and Ian Soraperra, "Fooled Twice: People Cannot Detect Deepfakes but Think They Can," *iScience* 24, no. 11 (November 2021).

evolve their deepfake generation methodology to evade detection. Thus, the generation and detection of fake evidence will continue to be a cat and mouse game. These are not challenges of a far-off future, they are already here. Judges will increasingly need to establish best practices to deal with a potential deluge of evidentiary issues.

We will discuss the evidentiary challenges posed by Generative AI using a civil lawsuit hypothetical. The hypothetical describes a scenario involving a U.S. presidential candidate seeking an injunction against her opponent for circulating disinformation in the weeks leading up to the election. We address the risk that fabricated evidence might be treated as genuine and genuine evidence as fake. Through this scenario, we discuss the best practices that judges should follow to raise and resolve Generative AI issues under the Federal Rules of Evidence.

We will then provide a step-by-step approach for judges to follow when they grapple with the prospect of alleged AI-generated fake evidence. Under this approach, judges should go beyond a showing that the evidence is merely more likely than not what it purports to be. Instead, they must balance the risks of negative consequences that could occur if the evidence turns out to be fake. Our suggested approach ensures that courts schedule a pretrial evidentiary hearing far in advance of trial, where both proponents and opponents can make arguments on the admissibility of the evidence in question. In its ruling, the judge should only admit evidence, allowing the jury to decide its disputed authenticity, after considering under Rule 403 whether its probative value is substantially outweighed by danger of unfair prejudice to the party against whom the evidence will be used.[5] Our suggested approach thus illustrates how judges can protect the integrity of jury

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[5] FED. R. EVID. 403.

deliberations in a manner that is consistent with the current Federal Rules of Evidence and relevant case law.

I. INTRODUCTION

Deepfakes and other AI-generated materials (AIM) are no longer novelties. Deepfakes have entered popular discourse due to their use (or alleged use) in entertainment, war, elections,[6] and other settings. Until recently, only relatively experienced technologists could create AIM. But now, anyone with an Internet connection and basic technology skills can access online tools to generate convincing fabricated video, audio, image, and text materials. The quality of AIM is rapidly improving, such that we should expect that very soon nearly anyone will be able to create convincing fake materials. The public will not be able to identify the materials as fake, and even experts will struggle to accurately distinguish genuine materials from fake. While technological solutions such as watermarking have been proposed, many experts believe that there will not be a definitive technological solution to the deepfake problem—at least anytime soon—especially when deepfakes are created by sophisticated actors, including by state actors.[7]

Deepfakes will present new challenges for courts, particularly in high-stakes cases involving elections, foreign actors, and other matters of national security. Courts are well equipped to handle the evidentiary issues of the past—such as those posed by social media.

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[6] See, e.g., Em Steck and Andrew Kaczynski, Fake Joe Biden Robocall Urges New Hampshire Voters Not to Vote in Tuesday's Democratic Primary, CNN (Jan. 22, 2024), https://www.cnn.com/2024/01/22/politics/fake-joe-biden-robocall/index.html [https://perma.cc/C3HU-UR9V].

[7] Many AI Researchers Think Fakes Will Become Undetectable, THE ECONOMIST (Jan. 17, 2024), https://www.economist.com/science-and-technology/2024/01/17/many-ai-researchers-think-fakes-will-become-undetectable [https://perma.cc/K6LQ-8FHU]. See also Siddarth Srinivasan, Detecting AI Fingerprints: A Guide to Watermarking and Beyond, BROOKINGS INST. (Jan. 4, 2024), https://www.brookings.edu/articles/detecting-ai-fingerprints-a-guide-to-watermarking-and-beyond/ [https://perma.cc/Q69E-VP9F]. ("Watermarking is the process of embedding an identifying pattern in a piece of media in order to track its origin.").

Currently, parties proffer expert witnesses, judges act as gatekeepers to ensure that experts are qualified, and juries determine the credibility of expert and fact witnesses, "find facts," and provide verdicts. However, social science research suggests that even if a person is aware that evidence is AIM, the fake evidence may still have a substantial impact on the person's perception of the facts or a situation.[8]

A 2022 study described this phenomenon as the "continued influence effect."[9] According to the study, once information is encoded in the memory, it remains in the memory to be reactivated and retrieved later.[10] When the information is corrected, the brain performs some knowledge revision, but that prior information is not simply erased but now "coexist[s] and compete[s] for activation."[11] The credibility of the purported source of misinformation may also influence how the fake evidence impacts a jury member. A 2020 study found that a correction of misinformation is less effective if that misinformation was attributed to a credible source and was "repeated multiple times prior to correction."[12] As it becomes easier to generate fake visual evidence, parties will be inclined to attempt to offer it as

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[8] Maura R. Grossman et al., The GPTJudge: Justice in a Generative AI World, 23 DUKE L. & TECH. REV. 1, 19 (2023); see also Rebecca A. Delfino, Deepfakes on Trial: A Call to Expand the Trial Judge's Gatekeeping Role to Protect Legal Proceedings from Technological Fakery, 74 HASTINGS L.J. 293, 25–27 (2023) (discussing studies showing impact of audiovisual evidence on juror perception and memory).

[9] Ullrich K. H. Ecker et al., The Psychological Drivers of Misinformation Belief and its Resistance to Correction, NATURE REVIEWS PSYCHOLOGY 1, 13-29 (2022).

[10] Id. at 16.

[11] Ecker et al., at 16. See also Nathan Walter & Sheila T. Murphy, How to Unring the Bell: A Meta-analytical Approach to Correction of Misinformation, COMMN. MONOGRAM 85(3), 423-441 (2018) for a study showing that correction of constructed misinformation, such as a fictional accident, is easier than correction of real-world misinformation, such as "denial of climate change," because of previous exposure to the real-world misinformation, and perhaps high involvement, that triggers a defensive processing.

[12] Nathan Walter & Riva Tukachinsky, A Meta-analytical Examination of the Continued Influence of Misinformation in the Face of Correction: How Powerful it is, Why Does it Happen, and How to Stop it? COMMUNICATION RESEARCH 47(2), 155-177 (2020).

evidence. A research study conducted in 2009 concluded that because jurors may get confused and frustrated when attorneys or witnesses explain technical or complex material, "visual aids help them retain information much better."[13] Their study showed that jurors retained up to "85% of visual information" as opposed to only about 10% of what they heard.[14]

This research illustrates why judges will need to exercise more control over whether alleged AIM goes to a jury. But do the Federal Rules of Evidence provide sufficient flexibility to handle AIM?

We posit that judges—if adequately educated about the unique challenges such deepfake evidence presents—can proactively manage evidentiary challenges related to alleged AIM under the existing Federal Rules of Evidence. Ordinarily, to introduce evidence, a party merely needs to show that it is relevant as set forth in Fed. R. Evid. 401 and authentic under Fed. R. Evid. 901. This presents a low bar. If the alleged AIM is central to a matter, it will easily satisfy the relevance requirement, and satisfying the authenticity standard at this stage merely requires a showing that it is more likely than not that the evidence "is what the proponent claims it is."[15]

We propose that judges proactively address potential problems in this process by requiring that the parties raise potential AIM issues in pre-trial conferences under Federal Rules of Civil Procedure 16 and 26(f). This will allow the parties to obtain discovery of evidence that corroborates or rebuts allegations that certain evidence is AIM and hire expert witnesses to address AIM. By being proactive, judges can also ensure that there is

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[13] Zachary B. Parry, Digital Manipulation and Photographic Evidence: Defrauding the Courts One Thousand Words at a Time, U. ILL. J. L. TECH. & POL'Y 175, 185 (2009).
[14] Id. at 184-185.
[15] FED. R. EVID. 901.

sufficient time to hold a hearing focused on the AIM, rather than having to handle the issues on the eve of or during trial without the parties having fully developed the factual and legal record.

Fed. R. Evid. 403 provides another tool to manage AIM. It allows judges to "exclude relevant evidence if its probative value is substantially outweighed by a danger of one or more of the following: unfair prejudice, confusing the issues, misleading the jury, undue delay, wasting time, or needlessly presenting cumulative evidence."[16] Research suggests that when contested audiovisual deepfakes go to the jury, even if the jury understands that they may be or are likely fake, the deepfake can nonetheless dramatically alter jurors' perceptions.[17] This could lead to unfair prejudice, misleading the jury, or another Rule 403 problem that could substantially outweigh the probative value of the evidence, providing a basis for excluding contested AIM.

In this paper, we present a hypothetical election interference case to show how judges and lawyers can proactively manage AIM issues under the existing Federal Rules of Evidence. There is a long history of foreign nation states interfering in the elections of other nation states.[18,] Recent examples include the alleged Russian interference in the 2016 and 2020 U.S. elections[19] as well as in the 2017 French Presidential election.[20] Since then,

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[16] FED. R. EVID. 403.

[17] See supra note 8.

[18] Vasu Mohan and Alan Wall, "Foreign Electoral Interference: Past, Present, and Future," GEORGETOWN JOURNAL OF INTERNATIONAL AFFAIRS 20 (Fall 2019): 110–119.

[19] See, e.g., Pippa Norris, "Electoral Integrity in the 2020 U.S. Elections," ELECTORAL INTEGRITY PROJECT (Dec. 2020),17.

[20] See, e.g., Emilio Ferrara, "Disinformation and Social Bot Operations in the Run Up to the 2017 French Presidential Election" (Preprint, submitted in 2017), https://arxiv.org/pdf/1707.00086.

deepfakes have been used in the 2023 Turkish[21] and Slovak[22] elections. In the 2023 Chicago mayoral election, a deepfake portrayed mayoral candidate Paul Vallas making statements that he did not make.[23] There is therefore strong reason to believe that deepfakes will be used in U.S. elections and that they will be the subject of allegations and counter-allegations that, at least in some cases, will end up being contested in court.

II. CREATING AND DETECTING AI-GENERATED MATERIAL

A. Creating AIM

There are several tools available today for creating fake media. For instance, fake images can be generated in response to a textual prompt by systems such as Microsoft's Bing Image Creator and OpenAI's DALL-E. Synthetic audio in the voice of a specific person can be generated using online services such as Speechify, with less than a minute of training audio of the target's voice. Synthetic video can be generated using online services such as Synthesia. A more recent product in this space is OpenAI's Sora, which can generate video from a text prompt. These are just a few of the well-known systems that can generate synthetic media.

Reputable services for creating synthetic media typically impose prohibitions on users creating malicious deepfakes, such as by requiring users to certify that they have

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[21] Pelin Ünker and Thomas Sparrow, Fact Check: Turkey's Erdogan Shows False Kilicdaroglu Video, DW (May 24, 2023), https://www.dw.com/en/fact-check-turkeys-erdogan-shows-false-kilicdaroglu-video/a-65554034 [https://perma.cc/2F3B-QGM5].

[22] Daniel Zuidijk, Deepfakes in Slovakia Preview How AI Will Change the Face of Elections, BLOOMBERG (Oct. 4, 2023), https://www.bloomberg.com/news/newsletters/2023-10-04/deepfakes-in-slovakia-preview-how-ai-will-change-the-face-of-elections [https://perma.cc/86DW-3BTR].

[23] Donie O'Sullivan, This Deepfake Surfaced in a Tight Mayoral Race. It's Just the Beginning, CNN (Feb. 7, 2024), https://www.cnn.com/videos/politics/2024/02/07/deepfake-artificial-intelligence-elections-chicago-paul-vallas-orig.cnn [https://perma.cc/4AVX-95K6].

permission to use the audio and video that they have uploaded.[24] But users can misrepresent their rights to use media and circumvent guardrails on such platforms. There are many examples of users generating prompts that create violent or sexual content by using prompts that the AIM generation platform did not expect.[25] To enhance traceability, some AIM-generation platforms embed watermarks or digital signatures within any AIM that they create.[26] The idea is that third parties can check for the presence of such watermarks. But these methods are far from foolproof and there is evidence that such watermarks can be removed, at least in some cases, without much difficulty.[27] Even if all online services could prevent malicous uses and added watermarks to outputs, people with moderate technical skills can access software that would allow them to create deepfakes without watermarks. Today, publicly accessible code-repositories such as GitHub include large amounts of software source code that can be used to create fake audio clips, images, and videos. Such code repositories rarely embed watermarks. Even in the rare cases when they do, the watermarks can be easily removed by programmers.

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[24] See e.g., Terms & Conditions, SPEECHIFY (May 25, 2023), https://speechify.com/termsSection 7.6(a) (“you represent and warrant … [y]ou own your User Material or have the right to submit it, and in submitting it you will not be infringing any rights of any third party, including intellectual property rights (such as copyright or trade mark), privacy or publicity rights, rights of confidentiality or rights under contract.”)

[25] Katyanna Quach, Attempts to Demolish Guardrails in AI Image Generators Blamed for Lewd Taylor Swift Deepfakes, THE REGISTER (Feb. 5, 2024), https://www.theregister.com/2024/02/05/deepfakes_taylor_swift_4chan_competition/ [https://perma.cc/AC2W-M644].

[26] Beatrice Nolan, OpenAI is Adding Digital Watermarks to its AI-Generated Images—But It's Not a Perfect Solution, BUSINESS INSIDER (Feb. 7, 2024), https://www.businessinsider.com/openai-adding-digital-watermarks-ai-images-deepfakes-2024-2 [https://perma.cc/3LVL-3PYS].

[27] Barry Collins, The Ridiculously Easy Way To Remove ChatGPT’s Image Watermarks, FORBES (Feb. 7, 2024), https://www.forbes.com/sites/barrycollins/2024/02/07/the-ridiculously-easy-way-to-remove-chatgpts-image-watermarks/?sh=13d1465a2dbc [https://perma.cc/YWT8-S3VT].

We will briefly describe a widely used technique and tool to create AIMs today: Generative Adversarial Networks (GANs)[28] and Stable Diffusion (SD), respectively.[29] Both GANs and SD can be applied to generate fake audio and video, and even fake multimodal content.

A GAN consists of two algorithms working together: a generator and a discriminator.[30] Suppose we want to generate a synthetic (i.e., "fake") image. In the first iteration, the generator creates an image by randomly selecting pixel values from some probability distribution. The result will be akin to the result of a monkey using a set of paintbrushes on a canvas. A batch of such images will be created and sent to the discriminator (a deep-learning classifier), which will likely discover that most, if not all the generator's images are fake. The prediction made by the discriminator is provided as feedback to the generator, which now knows that the images it had previously generated were detected as fakes. A second iteration repeats the process, but this time, the generator uses the feedback from[31] the previous iteration to avoid past mistakes. This new batch of fake images is fed back to the discriminator, which again makes its predictions and provides feedback to the generator. After thousands or even millions of iterations, an equilibrium is reached: the generator creates sufficiently realistic fake images so that over several consecutive iterations, the discriminator is unable to improve its ability to detect the images as fake. At this point, the images generated by the generator are the best possible versions.

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[28] See Ian Goodfellow, Jean Pouget-Abadie, Mehdi Mirza, Bing Xu, David Warde-Farley, Sherjil Ozair, Aaron Courville, and Yoshua Bengio, "Generative Adversarial Networks," *Communications of the ACM* 63, no. 11, (Nov. 2020): pp.139–44.

[29] See Ling Yang, Zhilong Zhang, Yang Song, Shenda Hong, Runsheng Xu, Yue Zhao, Wentao Zhang, Bin Cui, & Ming-Hsuan Yang, "Diffusion Models: A Comprehensive Survey of Methods and Applications," ACM COMPUTING SURVEYS 56, no. 4 (Nov. 2023), 38.

[30] See Goodfellow, supra note 28.

[31]

Stable Diffusion[32][33] starts with an image *I* (e.g., a 512 x 512 x 3 pixel image, i.e. a 512 x 512 image with three channels: red, green, and blue) and converts it into a latent representation, *L1,* which is much smaller in size (e.g., image). An example of this is provided in Figure 1 below. The first two dimensions of the original image (i.e., the 512 x 512 part) represents an image as a 2-dimensional matrix of pixels. These two dimensions represent the length and width of the image. The three channels represent the intensity of red, green, and blue colors in each pixel. Thus, when we see a standard 512 x 512 pixel image, we can think of this as three such images combined together—one corresponding to the red channel, one corresponding to the green channel, and one corresponding to the blue channel. The latent representation (e.g., a 64 x 64 x 3 image) is a technical representation that contains the "essence" of the original image but is much smaller. It is important to note that the latent representation does not have to be a 64 x 64 x 3sized image. It could just as well be a (64 x 64 x 4) image or some other size. “The latent representation does need to be much smaller than the original image (e.g. 64 x 64 x 4 = 16,384 which is much smaller than 512 x 512 x 3 = 786,432) to improve computational efficiency such as runtime and computational resources used. The smaller the size of the latent image, the less representative it will be of the original image. The larger the size, the more representative it is. However, a smaller sized image can be more efficiently processed, while a larger sized image requires more run-time and computational resources (e.g. GPU computing resources). Thus, there is a tradeoff between the size of the latent representation and the run-time and computational resources required. Next, "noise" is iteratively added to the

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[32] See Yang, supra note 29.

[33] Blattmann, A., Dockhorn, T., Kulal, S., Mendelevitch, D., Kilian, M., Lorenz, D., Levi, Y., English, Z., Voleti, V., Letts, A. and Jampani, V., 2023. Stable video diffusion: Scaling latent video diffusion models to large datasets. *arXiv preprint arXiv:2311.15127.*

latent representation, yielding a new latent representation, *L2*. One can think of “noise” as modifications to the red, green, and blue values for some of the pixels of the latent representation. The latent representation *L2* should still contain the “essence” of the original image *I* but will look different from *L1* because of the added noise. A denoising process[34] is now used to remove the noise from *L2*, but this is not done perfectly, leading to a new latent representation, *L3*. *L3* will look different from *L1* because the denoising process is not perfect. At this point, the process that converted *I* into *L1* is reversed, but this reversal is applied to *L3* to get a new image, *I3*, that has the same size as *I*. In our example, *I3* will still bear a resemblance to the source image *I* but will look different. A rendering of this process is provided in Figure 1 below. The generated image, *I3*, has some trees with more snow on them than the original image.

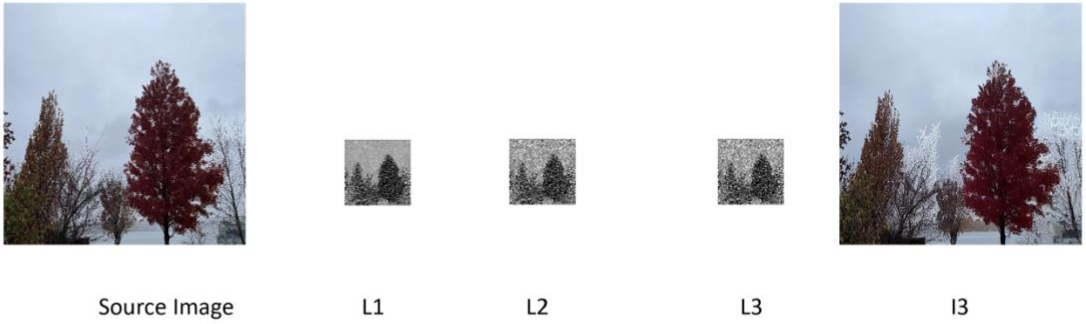

Figure 1: Stable Diffusion Image Generation Process Applied to an Image Taken by One of the Authors

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[34] Denoising is a process that attempts to clean up imperfections in an image. For instance, an image taken with a traditional camera might have spots or a bright ray of sunshine that over-illuminates a portion of the image. A similar phenomenon can occur in audio (e.g. when there is a crackle in a recorded phone call). Denoising methods attempt to correct such imperfections in captured media. See: Tian, C., Fei, L., Zheng, W., Xu, Y., Zuo, W. and Lin, C.W., 2020. Deep learning on image denoising: An overview. *Neural Networks*, *131*, pp.251-275.

B. Detecting AIM

A number of methods have been developed to detect deepfake media. In July 2023, several AI companies reached an agreement with the Biden administration[35] to place an embedded code (a "watermark") within any AIM. To ascertain whether a digital artifact is real or fake, all one would only need to look for the embedded code. Camera manufacturers are also trying to embed cryptographic signatures into images that are taken using that camera.[36] But, as explained in the last section, for a variety of reasons most experts doubt that watermarks will solve the deepfake problem.[37]

Early deepfake images were easily detected by humans because of "dumb" mistakes: an image of a person showing them having six fingers or a misshapen ear. In other cases, perfectly intelligible words (e.g., on a street sign) might have been mangled, such as a "STOP" sign reading "SWOT." Today's deepfakes are much more sophisticated than those of the past and such mistakes are less common. Instead, deepfake detectors (DDs) look for visual discontinuities in images. For instance, is the transition between a person's blue shirt sleeve and their dark skin a clear separation (as would be the case in a real image) or is there a region where there is a transition (with some portion near the border of the shirt sleeve and the skin looking different)? Similarly, DDs can look for improperly formed shadows (e.g., are the shadows consistent with the expected number of light sources?). In the case of videos, are there inconsistencies in the movement of the facial muscles and lips,

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[35] Matt O'Brien & Zeke Miller, White House Sets AI Safeguard Agreements with Amazon, Google, Meta, Microsoft and Other Tech Firms, PBS (Jul. 21, 2023), https://www.pbs.org/newshour/nation/white-house-sets-ai-safeguard-agreements-with-amazon-google-meta-microsoft-and-other-tech-firms [https://perma.cc/4Y2Q-WVXP]; Exec. Order No. 14,110, Executive Order on the Safe, Secure, and Trustworthy Development and Use of Artificial Intelligence, Fed. Reg. 24,283 (Oct. 30, 2023).

[36] See Matthew S. Smith, This Leica Camera Stops Deepfakes at the Shutter, IEEE SPECTRUM (Nov. 17, 2023), https://spectrum.ieee.org/leica-camera-content-credentials [https://perma.cc/Q9F4-P72H].

[37] See Vittoria Elliott, Big AI Won't Stop Election Deepfakes With Watermarks, WIRED (Jul. 27, 2023), https://www.wired.com/story/ai-watermarking-misinformation/ [https://perma.cc/99GE-9KU4].

and the rendered speech? In the case of audio, does the audio sound monotonous? Or does it have the usual ups and downs of ordinary human speech? These important questions underlie some of the DDs available today.

In addition to DD methods that seek to detect genuinely new deepfakes, there are also specialized systems that are capable of finding copies or variations of images already known to be deepfakes: systems such as PhotoDNA[38] from places such as Dartmouth College and Microsoft have been used for well over a decade to find near-copies of images known to depict illegal content, such as terrorist imagery and child sexual abuse material (CSAM). Such systems can be used to find copies of deepfake images after someone has already found an initial version that was separately found to be a deepfake.

Unfortunately, DD algorithms are far from perfect. Several authors of this paper (Gao, Pulice, Subrahmanian) have conducted tests on a small suite of videos, both real and deepfake. Table 1 shows their findings. One hundred real videos were collected from the Internet, as well as 100 well-known deepfakes. The authors also generated 100 deepfakes in the Northwestern Security & AI Lab (NSAIL). They tested four well-known deepfake detectors (DD1 through DD4), which included the winner of the Meta Deepfake Detection Challenge.[39] DD1 labeled every real video as real, but also labeled almost every fake video as real. Simply put, DD1 labeled almost everything as real and found almost no fake videos, showing a high false-positive rate. DD2 arguably did the best, getting an error rate of only 3% on the real videos, but still huge error rates (76% and 89%) on the two fake datasets. DD3 was slightly better at detecting fakes (error rates of 87% and 71%) but made more

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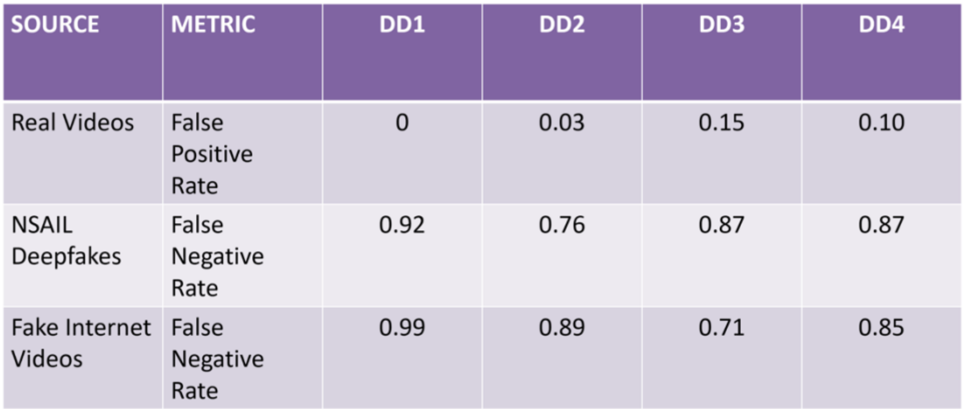
[38] Farid, H., 2021. An overview of perceptual hashing. *Journal of Online Trust and Safety*, *1*(1).

[39] See Cristian Canton Ferrer et al, Deepfake Detection Challenge Results: An Open Initiaitve to Advance AI, META (Jun. 12, 2020), https://ai.meta.com/blog/deepfake-detection-challenge-results-an-open-initiative-to-advance-ai/ [https://perma.cc/UEC9-YR3B].

errors on real videos (15%). DD4's performance was close to that of DD3, with a 10% error rate on real videos and 85% and 87% error rates on fake ones. While many of the deepfakes would have been easily detected by a human, these detectors were biased toward labeling videos as real, thereby making few errors on real videos and many on fake videos.

Table 1: Deepfake Detector Error Rates



SOURCE	METRIC	DD1	DD2	DD3	DD4
Real Videos	False Positive Rate	0	0.03	0.15	0.10
NSAIL Deepfakes	False Negative Rate	0.92	0.76	0.87	0.87
Fake Internet Videos	False Negative Rate	0.99	0.89	0.71	0.85

These results do not provide confidence that today's DDs can reliably distinguish between real and fake videos. Given concerns about the validity of DDs (i.e., the accuracy of a DDs predictions of whether media is real or fake) as well as their reliability (i.e., the consistency of making accurate predictions about whether media is real or fake),[40] the introduction of DDs in a legal matter will likely face hurdles under the Federal Rules of Evidence.[41]

III. ELECTION-INTERFERENCE HYPOTHETICAL

The possibility of foreign interference in elections by using deepfakes presents a serious challenge for national security. When alleged deepfakes are deployed, there will be

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[40] Paul W. Grimm et al., Artificial Intelligence as Evidence, 19 NW. J. TECH. & INTELL. PROP. 9, 89 (2021).

[41] See id.

concerns about possible foreign interference. No matter the specific facts, the related uncertainty regarding election integrity is a threat to national security in various ways.

First, when there are allegations of deepfake use in an election, there is the possibility that one or more candidates will challenge the legitimacy of the election. As an example, just two days before the 2023 Slovak election, an audio deepfake depicted anti-Russian candidate Michal Šimečka discussing how he rigged the election.[42] Slovakia's election rules forbid candidate statements within 48 hours (two days) of the poll—making it near impossible for the candidate to question the authenticity of the deepfake. The outcome of the election may have been a casualty of the deepfake, leading to a more pro-Russian government.[43]

Second, allegations of deepfake use may sow distrust amongst the population in the elected government, even if the allegations of deepfake use were false.[44]

Third, deepfakes might deter certain voters from going to the polls. As an example, February 2024 witnessed the release of an audio deepfake which falsely impersonated President Biden telling voters not to go to the polls.[45] Should such deepfakes not be quickly debunked in the future, the outcome of an election could be compromised. These are just

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[42] See Curt Devine et al., A Fake Recording of a Candidate Saying He'd Rigged the Election Went Viral. Experts Say It's Only the Beginning, CNN (Feb. 1, 2024), https://www.cnn.com/2024/02/01/politics/election-deepfake-threats-invs/index.html [https://perma.cc/ZW6L-P9P2].

[43] See Morgan Meaker, Slovakia's Election Deepfakes Show AI Is a Danger to Democracy, WIRED (Oct. 3, 2023), https://www.wired.com/story/slovakias-election-deepfakes-show-ai-is-a-danger-to-democracy/ [https://perma.cc/2VZ8-R73G].

[44] Governments Use of Deepfakes, pg. 3 (https://csis-website-prod.s3.amazonaws.com/s3fs-public/2024-03/240312_Byman_Government_Deepfakes.pdf?VersionId=OAFKvrOi9ojseIjOKhzqi672claqU.if)

[45] See Shannon Bond, AI Fakes Raise Election Risks as Lawmakers and Tech Companies Scramble to Catch Up, NPR (Feb. 8, 2024), https://www.npr.org/2024/02/08/1229641751/ai-deepfakes-election-risks-lawmakers-tech-companies-artificial-intelligence [https://perma.cc/69FE-KJHY].

three possible ways in which deepfakes could be used to compromise the security of an election and help impose an improperly elected government on a democracy.

A. Hypothetical scenario

Our scenario involves a hypothetical election-interference case brought in federal court by presidential candidate, Connie, against PoliSocial, a political social-media strategy company, and Eric, Connie's opponent.

Assume that it is August 4, 2028, three months before the 2028 U.S. presidential election. Connie alleges that Eric and entities affiliated with Eric, including PoliSocial, published fake AIM that defamed Connie. Since the party conventions, which took place in early July 2028, a massive social-media campaign involving a network of 6,000 bot accounts has unleashed a wave of disinformation targeting Connie. Connie's lawyers have obtained evidence that these bot accounts all posted content from the same IP address, a third-party data operations center in New Hampshire. A news investigation subsequently showed close coordination between Eric's campaign and the third party, a political action committee ("PAC") that supports Eric.

More important to national security, Connie alleges that the fake AIM is designed to interfere with the upcoming election by attempting to intimidate Connie's supporters and prevent them from voting for her because of her alleged connections to Chinese officials. Connie also alleges that the AIM is designed to mobilize Eric's supporters to further intimidate and threaten Connie's supporters so that they do not exercise their constitutional right to vote for Connie. Connie seeks an injunction requiring Eric to retract the defamatory statements, admit that the video and audio recordings released were fake AIM, and cease engaging in defaming Connie and taking actions that seek to intimidate and threaten voters and interfere with the exercise of their right to vote.

Allegations posted by these bot accounts included videos of Connie in a variety of compromising poses with a man later identified as a Chinese embassy official. These videos, from security cameras and private cell phones, were geolocated to expensive resorts, beaches, and spas. In addition, many audio clips appeared to show Connie soliciting money from an unnamed man whose phone was later geolocated in Beijing at the time of the call.

The messages and allegations were amplified by frequent social media messages posted by the 6,000 bot accounts using a variety of hashtags such as #CheatingConnie, #CrookedConnie, and #VoteConnieOut. Despite desperate denials from Connie's campaign, the stories spread like wildfire, first on social media, and then on mainstream news and broadcast media. The posts were also sent to social media groups frequented by Connie's supporters.

Polls suggest a close race between the two candidates. Both campaigns expect a razor-thin margin setting up the potential for several rounds of recounts in key battleground states, thus every vote will matter.

Several of the circulating videos show ballot boxes being stuffed in pro-Connie districts during the primary elections in New Hampshire and South Carolina. These videos also went viral, first on social media, and later in mainstream news and broadcast TV channels. Subsequent videos show voters attending Connie's rallies being confronted by "election integrity" groups threatening her supporters with violence at the polls. Members of these groups have been linked to Eric's campaign.

Meanwhile, Connie's campaign received a tip in the form of a recording of PoliSocial CEO John Doe apparently speaking with Eric just after a campaign event in late July 2028. In this clip, John Doe is caught saying "We buried her, Eric. The videos are doing the trick. This country is not ready for a woman in the Oval Office. Congrats." Geolocation data showed that the tipster's phone was near the phones of both John Doe and Eric at the time the alleged audio recording was made.

At the same time, the campaign received another audio recording of Eric during a prior senate election three years ago. The recording allegedly captures Eric and a campaign staffer discussing the use of deepfake videos to implicate their opponent in a similar corruption scandal. Eric is caught saying "Wow! This technology is so good now it would be impossible for anyone to spot it as a fake." When confronted with this evidence, John Doe and Eric both insisted that the audios are deepfakes. Connie's campaign claims that the audio recordings are smoking guns.

IV. CLAIMS UNDER THE VOTING RIGHTS ACT AND FOR DEFAMATION

This hypothetical presents several critical pieces of audio and audiovisual evidence that both parties will seek to introduce to buttress their claims and defenses. These include the alleged videos showing Connie in compromising poses with a Chinese embassy official and showing ballot boxes being stuffed by her constituents in the primaries; the alleged audio recordings of conversations between Connie and an individual geolocated in Beijing; the conversation between Eric and PoliSocial's CEO, John Doe; and the recording of Eric and his campaign staffer from three years ago.

Given the highly public nature of the presidential election campaign, there are several considerations that would frame a trial. For one, there is the question of irreparable harm to both campaigns from the widespread dissemination of the audiovisual evidence in the public domain through both conventional and social media platforms. Such dissemination would likely have a lasting impression on public perception of these candidates before the trial begins. Relatedly, given the high-profile nature of presidential campaigns, it is also likely that potential jurors will have been exposed to the same evidence. Moreover, both candidates have an incentive to launch an inauthentic "deepfake defense" in which they challenge genuine audiovisual evidence as being AIM to support their respective claims and defenses, benefitting from the "Liar's Dividend."[46] The Liar's Dividend describes the phenomenon where some actors will seek to "escape accountability for their actions by denouncing authentic audio and video as deep fakes."[47] They would attempt to invoke the public's growing skepticism of audio and video evidence as it learns more about the power of AIM.[48]

A. Voting Rights Act Claim

To bring a claim under the Voting Rights Act, Connie must show that Eric and his affiliates intimidated, threatened, or coerced her supporters or attempted to do so "for voting or attempting to vote."[49] Connie will seek to introduce the videos showing her supporters being confronted and harassed at rallies and warned against voting for her, and will argue that the videos are fakes created by Eric's campaign designed to intimidate people so that they do not go to the polls and vote for her. She will also seek to introduce the posts targeting her supporters on social media and allege that Eric and his supporters are using such posts to spread disinformation and discourage her supporters from exercising their right to vote. Eric will deny responsibility for the videos and contend that he has no reason to believe that the videos have been faked but he is still not responsible for the conduct of any individuals depicted in the videos. Eric will further argue that citizens have constitutional rights, including under the First Amendment, to protest undemocratic activities designed to undermine fair elections.

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[46] See Danielle K. Citron & Robert Chesney, Deep Fakes: A Looming Challenge for Privacy, Democracy, and National Security, 107 CAL L. R. 1753, 1785 (2019).

[47] Id.

[48] Id.

[49] 52 U.S.C. § 10307(b).

B. Defamation claim

In addition to the Voting Rights Act claim, Connie will bring a claim for defamation to buttress her request for relief that Eric retract his claims, admit that the content of the audio and videos showing her in potentially illegal or compromising positions are fake, and be enjoined from publishing additional false claims. To prove defamation, Connie must show that (i) a false statement was made by Eric's campaign, (ii) the statement was communicated to a third party, (iii) Eric's campaign acted with actual knowledge that the statement was false, and (iv) Connie suffered harm.[50] Since Connie is a public figure, Connie will also have to show that with regard to the allegedly false material, Eric acted with "actual malice—that is, with knowledge that it was false or with reckless disregard of whether it was false or not."[51]

Eric will argue that the compromising audio and video recordings of Connie are real and attempt to use them as evidence to show that no false statements were made. If the alleged statements are true, Connie cannot state a defamation claim. Connie in turn will argue that they are fake AIM. Connie will seek to introduce the audio recording appearing to capture a conversation between Eric and PoliSocial's CEO to show that Eric's campaign created and spread false information about her campaign. Eric will dispute the authenticity of the audio recording, arguing that it is AIM. Connie will also try to introduce the audio recording from three years ago of Eric talking to a staffer about using deepfakes against his opponent in a previous senate election. As such, both Eric and Connie are likely to challenge the admissibility of audiovisual evidence on the basis that it is AIM and therefore does not meet the authentication requirements under the Federal Rules of Evidence.

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[50] See Defamation, LEGAL INFORMATION INSTITUTE (June 2023), https://www.law.cornell.edu/wex/defamation [https://perma.cc/LK4Q-GVVD].
[51] New York Times Co. v. Sullivan, 376 U.S. 254, 280 (1964).

In this hypothetical, the admissibility of the audiovisual evidence is central to the disposition of the case—even more so if the candidates are unable to provide other forms of corroborating evidence to support their claims or defenses. In determining the admissibility of the evidence, the court will also have to consider the risk of unfair prejudice to either party if the disputed evidence is admitted and turns out to be fake, but sways a jury nonetheless.

V. FEDERAL RULES OF EVIDENCE FRAMEWORK

When a party introduces non-testimonial evidence, they must meet the admissibility requirements of relevance under Fed. R. Evid. 401 and authenticity under Fed. R. Evid. 901. "Evidence is relevant if: (a) it has any tendency to make a fact more or less probable than it would be without the evidence, and (b) the fact is of consequence in determining the action."[52] "Even evidence that has a slight tendency to resolve a civil or criminal case meets the standard."[53] In addition, Fed. R. Evid. 402 states that "Relevant evidence is admissible unless any of the following provides otherwise: the United States Constitution; a federal statute; these rules [of evidence]; or other rules prescribed by the Supreme Court. Irrelevant evidence is not admissible."[54] "In essence, Rule 402 creates a presumption that relevant evidence is admissible, even if it is minimally probative, unless other rules of evidence or sources of law require its exclusion."[55]

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[52] FED. R. EVID. 401.
[53] Grimm et al., supra note 40, at 87.
[54] FED. R. EVID. 402.
[55] Grimm et al., supra note 40, at 87.

A. Rule 403 allows the exclusion of relevant evidence when probative value is substantially outweighed by unfair prejudice

Fed. R. Evid. 403, however, states that "the court may exclude relevant evidence if its probative value is substantially outweighed by one or more of the following: unfair prejudice, confusing the issues, misleading the jury, undue delay, wasting time or needlessly presenting cumulative evidence."[56] The Advisory Committee Notes accompanying Rule 403 state that "[t]he case law recognizes that certain circumstances call for the exclusion of evidence which is of unquestioned relevance. These circumstances entail risks that range from inducing decisions on a purely emotional basis, at one extreme, to nothing more harmful than merely wasting time, at the other extreme. Situations in this area call for balancing the probative value of and need for the evidence against the harm likely to result from its admission."[57] Rule 403 therefore establishes a balancing test which tilts in favor of admissibility and permits the exclusion of relevant evidence upon a sufficient showing of unfair prejudice to the party against whom the evidence is introduced, or some other specific problematic outcome.[58]

Mere prejudice alone is insufficient to permit the exclusion of relevant evidence; the prejudice must be sufficiently unfair to warrant exclusion under Rule 403.[59] Specifically, Rule 403 provides, "Unfairness may be found in any form of evidence that may cause a jury to base its decision on something other than the established propositions in the case."[60] It

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[56] FED. R. EVID. 403.

[57] FED. R. EVID. 403 Advisory Committee Notes (emphasis added).

[58] See Paul W. Grimm et al., Artificial Intelligence as Evidence, 19 NW. J. TECH. & INTELL. PROP. 9, 88 (2021).

[59] See JACK B. WEINSTEIN & MARGARET A. BERGER, WEINSTEIN'S FEDERAL EVIDENCE § 403.04 (2d ed. 2024).

[60] See id.

further provides, "Prejudice is also unfair if the evidence was designed to elicit a response from the jurors that is not justified by the evidence."[61]

Relevant evidence may also be excluded under Rule 403 when it might confuse the issues or mislead the jury. Just as with unfair prejudice, this analysis is highly fact dependent.[62] One recurring basis for excluding evidence as confusing the issues or misleading a jury is when plausible evidence would be very difficult to rebut.[63] "Courts are reluctant to admit evidence that appears at first to be plausible, persuasive, conclusive, or significant if detailed rebuttal evidence or complicated judicial instructions would be required to demonstrate that the evidence actually has little probative value."[64]

Courts have excluded some types of scientific and statistical evidence under Rule 403, particularly "if the jury may use the evidence for purposes other than that for which it was introduced."[65] Courts have also excluded legal materials such as statutes, cases and constitutional provisions.[66] Finally, courts may exclude relevant evidence "if its probative value is substantially outweighed by danger of undue delay, wasting time, or needlessly presenting cumulative evidence."[67]

Rule 403 does not confer judges with the power to determine witness credibility, which remains the domain of the jury.[68] Judges may "exclude testimony that no reasonable person could believe, where it flies in the face of the laws of nature or requires inferential leaps of faith rather than reason."[69] Apart from such outliers, Rule 403 leaves the power to

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[61] See id.
[62] See id. at § 403.05(2).
[63] See id. at § 403.05(3)(b).
[64] See id.
[65] See id. at § 403.05(3)(c).
[66] See id. at § 403.05(3)(a).
[67] See id. at § 403.06.
[68] See CHRISTOPHER B. MUELLER & LAIRD C. KIRKPATRICK, FEDERAL EVIDENCE § 4.12 (4th ed. 2023).
[69] See id.

determine credibility with the jury and does not let the judge supplant the jury's views on credibility.

Appellate courts afford trial courts wide discretion in exercising their Rule 403 powers, and trial-court decisions are only reversed where there has been an abuse of discretion.[70] Nevertheless, appellate courts have recognized that this power should be exercised sparingly given that the balancing test weighs in favor of admissibility.[71] Furthermore, appellate courts have indicated a preference for trial judges to state their findings on the record rather than simply presenting their conclusions.[72] "The greater the risks, the more vital the evidence, the more thorough should be the consideration given to objections under Rule 403, and the more need there is for trial judges to give some indication for their decisions."[73] Furthermore, "sidebar conferences where the matter is raised and discussed should be on the record."[74]

B. Authenticity under Rule 901 is a low bar

The second requirement for admissibility of non-testimonial evidence is that it must meet the authenticity requirement under Fed. R. Evid. 901. Rule 901 states that "the proponent must produce evidence sufficient to support a finding that the item is what the proponent claims it is."[75] "This low threshold allows a party to fulfill its obligation to authenticate non-testimonial evidence by a mere preponderance, or slightly more than a coin toss."[76] Rule 901(b) lists ten non-exclusive ways in which a proponent can demonstrate

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[70] See id.

[71] See id.

[72] See id.; See also FED. R. EVID. 103(c) ("The court may make any statement about the character or form of the evidence, the objection made, and the ruling.").

[73] See id.

[74] See id.

[75] FED. R. EVID. 901(a).

[76] Taurus Myhand, Once the Jury Sees It, the Jury Can't Unsee It: The Challenge Trial Judges Face When Authenticating Video Evidence in the Age of Deepfakes, 29 WIDENER L. R. 171, 177 (2022).

authenticity.[77] In the context of audio evidence, authentication can be satisfied using an "opinion identifying a person's voice—whether heard firsthand or through mechanical or electronic transmission or recording—based on hearing the voice at any time under circumstances that connect it with the alleged speaker."[78]

There are two theories under which video evidence can be admitted: "either as illustrative evidence of a witness's testimony (the "pictorial-evidence theory") or as independent substantive evidence to prove the existence of what is depicted (the "silent-witness theory")."[79] Under the pictorial-evidence theory, video evidence can be authenticated by any witness present when it was made who perceived the events depicted.[80] Videos admitted under the silent-witness theory are subject to additional scrutiny since there are no independent witnesses to corroborate their accuracy.[81] In instances where videos are the products of security surveillance cameras, they could be authenticated as "the accurate product of an automated process."[82] Ultimately, the threshold for admissibility remains low and once the proponent of the evidence shows that a reasonable jury could find the video authentic, the burden shifts to the opponent to demonstrate that it is clearly inauthentic.[83]

C. The Federal Rules of Evidence allocate greater factfinding power to juries

Finally, it is also worth examining how the Federal Rules of Evidence delegate adjudication responsibilities on evidentiary admissibility between the judge and the jury. Ultimately, the Federal Rules of Evidence were designed to allocate greater preliminary

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[77] Fed R. Evid. 901(b).

[78] Fed R. Evid. 901(b)(5).

[79] See Myhand, supra note 76, at 177.

[80] See id.

[81] See id.

[82] FED. R. EVID. 901(b)(9).

[83] Myhand, supra note 79, at 179.

factfinding power to juries and reflected a turn away from the traditional English common law approach that gave judges unfettered power in determining the admissibility of evidence.[84] This can be seen in the interplay between Fed. R. Evid. 104(a), which defines the role of the trial judge in making preliminary determinations regarding the admissibility of evidence, the qualification of witnesses, and the existence of an evidentiary privilege,[85] and Fed. R. Evid. 104(b), the so-called "conditional-relevance rule," which provides that when the relevance of evidence depends on the existence of a fact, "proof must be introduced sufficient to support a finding that the fact does exist."[86] While it may not be apparent from the text of Rule 104(b) itself, what this means in essence is that when one party claims that evidence is authentic, and therefore relevant and admissible, but the opposing party claims that it is fake, and therefore not relevant to prove any disputed fact, it is the *jury*, not the judge, that must resolve the fact dispute and decide which version of the facts it accepts, so long as the judge finds that sufficient proof has been introduced for the jury to be able to reasonably find that the evidence is authentic.[87]

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[84] See Edward J. Imwinkelried, Trial Judges: Gatekeepers or Usurpers? Can the Trial Judge Critically Assess the Admissibility of Expert Testimony Without Invading the Jury's Province To Evaluate the Credibility and Weight of the Testimony?, 84 MARQ. L. REV. 1, 8 (2000); see also EDWARD J. IMWINKELRIED, 45 AM. JUR. TRIALS 1 §§ 6–9 (2024) (tracing the history of Federal Rule of Evidence 104).

[85] FED. R. EVID. 104(a) ("The court must decide any preliminary question about whether a witness is qualified, a privilege exists, or evidence is admissible. In so deciding, the court is not bound by evidence rules, except those on privilege.").

[86] FED. R. EVID. 104(b) ("When the relevance of evidence depends on whether a fact exists, proof must be introduced sufficient to support a finding that the fact does exist. The court may admit the proposed evidence on the condition that the proof be introduced later.").

[87] Fed. R. Evid. 104(b) advisory committee notes ("If preliminary questions of conditional relevancy were determined solely by the judge, as provided in subdivision (a) [of Rule 104], the functioning of the jury as a trier of fact would be greatly restricted and in some cases virtually destroyed. These are appropriate questions for juries. Accepted treatment, as provided in the rule, is consistent with that given fact questions generally. The judge makes a preliminary determination whether the foundation evidence is sufficient to support a finding of fulfillment of the condition. If so, the item is admitted. If after all the evidence on the issue is in, pro and con, the jury could reasonably conclude the fulfillment of the condition is not established, the issue is for them. If the evidence is not such as to allow a finding the judge withdraws the matter from their consideration.")

Proponents of evidence that is challenged as AIM could argue that the incriminating evidence's ultimate authenticity should be determined by the jury as a part of it's role as a decider of contested facts under Fed. R. Evid. 104(b). They could further argue letting the jury make such factual determinations would not undermine the jury deliberation process.[88] For instance, Rule 104(b) allocates to the jury the responsibility of determining the authenticity of an exhibit, such as a letter.[89] The jury could simply "disregard the letter's contents during their deliberations" if they determined it was a forgery.[90] The rules show a particular concern with letting the judge entirely exclude evidence because they fear doing so would greatly restrict the jury's function as a trier of fact, and in some cases, virtually eliminate it.[91]

D. Potential bases for excluding possible deepfakes under Rule 403

The critical evidentiary issue that the judge must decide is whether Fed. R. Evid. 104(b) requires the judge to admit the contested audiovisual evidence and let the jury determine the disputed fact of its authenticity, or whether the judge, as gatekeeper under Fed. R. Evid. 104(a), may (or must) exclude the audiovisual evidence under Rule 403 if the judge finds that the unfair prejudice to the opponent of admitting the evidence substantially outweighs its probative value.

When considering audiovisual evidence, studies have shown that once the jury has seen disputed videos, they are unlikely to be able to put them out of their minds whether or not they are told they are fake.[92] Our research has not disclosed any caselaw addressing

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[88] See Delfino, supra note 8, at 324.
[89] See FED. R. EVID. 104(b) advisory committee notes.
[90] See Imwinkelried, supra note 69, at 11.
[91] See FED. R. EVID. 104(b) advisory committee notes.
[92] See Grossman et al., supra note 8; Delfino, supra note 8; "[T]he recommendation to the jury of a mental gymnastic which is beyond, not only their powers, but anybody's else." Nash v. United States, 54 F.2d 1006, 1007 (2d. Cir. 1932) (Judge Learned Hand referencing limiting instructions).

this dilemma in the context of AIM. However, in other contexts, there is ample precedent supporting the authority of the trial judge to exclude evidence under Rule 403 as unfairly prejudicial even if the judge has concluded that a reasonable jury could find by a preponderance of the evidence that it is authentic, and therefore relevant.

In *Johnson v. Elk Lake School District*, the Third Circuit discussed the appropriate roles for the trial judge and the jury under Fed. R. Evid. 104(a) and 104(b) with respect to admissibility of evidence under Fed. R. Evid. 415. Fed. R. Evid. 415 governs when evidence of the adverse party's prior uncharged sexual assault or child molestation may be admitted, in a civil case involving a claim for relief based on a party's alleged sexual assault or child molestation.[93] Specifically, the Third Circuit considered whether the trial judge had to first make "a preliminary finding by a preponderance of the evidence under Federal Rule of Evidence 104(a) that the act in question qualifies as a sexual assault and that it was committed by the defendant."[94] The Third Circuit ruled that the trial court need not make such a preliminary finding. Instead, it held that "the court may admit the evidence so long as it is satisfied that the evidence is relevant, with relevancy determined by whether a jury could reasonably conclude by a preponderance of the evidence that the past act was a sexual assault and that it was committed by the defendant," citing Fed. R. Evid. 104(b).[95]

Importantly, however, the Court added "[w]e also conclude . . . that even when the evidence of a past sexual offense is relevant [(i.e., satisfies Rule 104(b)[96]], the trial court retains discretion to exclude it under Federal Rule of Evidence 403 if the evidence's probative value is substantially outweighed by the danger of unfair prejudice, confusion of

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[93] Johnson v. Elk Lake Sch. Dist., 283 F.3d 138, 144–45 (2002).

[94] Id. at 143-44.

[95] Id. at 144.

[96] Id. at 155.

the issues, or misleading the jury, or by considerations of undue delay, waste of time, or needless presentation of cumulative evidence."[97]

Similarly, in *Huddleston v. United States*, which was cited as authority by the Third Circuit in *Johnson*, the Supreme Court considered the proper roles of the trial judge under Fed. R. Evid. 104(a) and the jury as decider of disputed facts under Fed. R. Evid. 104(b) in connection with admissibility of evidence of "other crimes, wrongs, or acts" under Fed. R. Evid. 404(b).[98] Writing for the Court, Chief Justice Rehnquist rejected the petitioner's argument that the trial judge was required by Rule 104(a) to make a preliminary determination that the defendant committed the similar act before allowing it to be admitted.[99] Rather, the Court held that the only requirement for admission of Rule 404(b) evidence is that it be relevant, which only occurs "if the jury can reasonably conclude that the act occurred and that the defendant was the actor . . . . Such questions of relevance conditioned on a fact are dealt with under Federal Rule of Evidence 104(b)."[100]

Chief Justice Rehnquist then addressed the issue of whether "unduly prejudicial evidence might be introduced under Rule 404(b)," concluding that the protection against such an outcome lies in "the assessment the trial court must make under Rule 403 to determine whether the probative value of the similar act evidence is substantially outweighed by its potential for unfair prejudice."[101] Thus, as in *Johnson*, the *Huddleston* Court recognized that the trial judge retained the authority under Fed. R. Evid. 403 to

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[97] Id.

[98] Huddleston v. United States, 485 U.S. 681, 682 (1988). Johnson v. Elk Lake Sch. Dist., 283 F.3d 138, 144–45 (2002).

[99] Id.

[100] Id. at 689.

[101] Id.

exclude evidence even when a reasonable jury could conclude, by a preponderance of the evidence under Rule 104(b), that it was relevant.[102]

Johnson and *Huddleston* involved evidence about prior acts and convictions,[103] which, it can be argued, is of relatively low probative value. But when challenged AIM goes to the heart of the matter, such as is the case with most of the alleged deepfakes in our hypothetical, a strong argument can be made that the probative value is much greater if the evidence is found to be authentic.

Regarding unfair prejudice, evidence admitted under Rule 403 of prior actions and convictions presents cause for concern that a jury will find against a party based not on the facts of the current action, but rather on a character inference based on past actions. This is particularly troubling because it is difficult for a party to rebut or mitigate the jury's tendency to use evidence of prior actions and convictions in this way. Thus, not only can the evidence be prejudicial, but the prejudice can also be "unfair."

In the case of audiovisual evidence, as discussed above, studies routinely show that it can have a tremendous impact on juror perception and memory, even when a juror understands that the evidence may be or is likely fake.[104] One experiment showed that people were more likely to confess to acts that they had not committed when they were presented with doctored videos ostensibly showing them engaging in the act.[105] In a subsequent study, researchers found that participants presented with doctored videos were

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[102] Id. at 687.

[103] Huddleston v. United States, 485 U.S. 681, 682 (1988).

[104] See Grossman et al., supra note 8; Delfino, supra note 8.

[105] Yael Granot, Neal Feigenson, Emily Balcetis & Tom Tylr, In the Eyes of the Law: Perception Versus Reality in Appraisals of Video Evidence, 24 PSYCH. PUB. POL'Y & L. 93, 97–98 (2017) citing Nash, R. A., & Wade, K. A. (2009). Innocent but proven guilty: Eliciting internalized false confessions using doctored-video evidence. *Applied Cognitive Psychology, 23,* 624–637 (describing a study where innocent participants were shown doctored videos of them illicitly taking money placed in front of them were more likely to confess having done so and internalize the belief that they did so).

more likely to sign witness statements accusing their peers of cheating than those who were simply told about the alleged infractions.[106] Moreover, the participants in the study were aware that their statements would be used to punish their peers.[107] These studies clearly show that "video evidence powerfully affects human memory and perception of reality."[108]

Thus, there is potentially substantial prejudice to the party objecting to the deepfake and given the potential impact even when the deepfake is strongly suspected to be fake, it is straightforward to find that this is unfair. On the other hand, as will be discussed in later sections, the defendant will have the opportunity to challenge the evidence using various tools of discovery and expert witness testimony, possibly mitigating the unfairness of the alleged deepfake being presented to the jury. But in some circumstances, it might be very difficult to rebut or mitigate the jury's tendancy to be swayed by a possible deepfake, even one that the jury determines is not real, thus supporting the argument that allowing it to go to the jury would be unfair.

In summary, it is our contention that with respect to AIM deepfakes, the judge should not submit the challenged AIM evidence to the jury if the judge determines that its probative value is substantially outweighed by unfair prejudice to the objecting party. This holds true even if the judge determines that a reasonable jury could determine that the challenged evidence is authentic by a preponderance of the evidence. In addition to the text of the Rules, there is ample case law to support the proposition that judges can exclude unfairly prejudicial evidence, even where relevance and authenticity is established. Additionally, Fed. R. Evid. 102 states that the rules of evidence should be construed to promote fairness, develop evidence law, ascertain the truth, and secure a just

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[106] Kimberly A. Wade, Sarah L. Green & Robert A. Nash, Can Fabricated Evidence Induce False Eyewitness Testimony?, 24 APPLIED COG. PSYCH. 899, 900 (2010).
[107] Id.
[108] Delfino, supra note 8, 311.

determination.[109] There is ample authority for our approach to handling alleged AIM under the Federal Rules of Evidence.

VI. APPLYING THE GPTJUDGE FRAMEWORK FOR RESOLVING AUTHENTICITY DISPUTES

How should a court handle the allegedly fake AIM evidence at the heart of Connie's and Eric's claims and defenses? Recall that it is August 4, 2028, merely three months before the 2028 U.S. presidential election. Connie and her lawyers want to push the case forward rapidly. Eric may have less interest in moving quickly, as, for the most part, the status quo seems to benefit him and his campaign. If the court follows traditional scheduling practices, the risk is that the evidentiary issues related to the allegedly fake AIM evidence will not be fully developed, potentially derailing a trial, and producing a less-than-optimal outcome from the perspective of the parties, the judge, and the public. How can the court prevent this?

Below, we analyze aspects of the hypothetical litigation between Connie and Eric by applying the framework for addressing allegedly fake AIM evidence developed by Maura R. Grossman, Hon. Paul W. Grimm (ret.), Daniel G. Brown, and Molly (Ximing) Xu in their article, *The GPTJudge: Justice in a Generative AI World*.[110] This framework provides the parties and the court with a step-by-step roadmap for administering and ruling on admissibility challenges to alleged AIM evidence. While Grossman and co-authors provide a general framework for dealing with AIM as evidence, in this article, we focus specifically on authenticity challenges to the introduction of *audiovisual* evidence—evidence that one party puts forth as genuine and the other contests as being a "deepfake."

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[109] FED. R. EVID. 102 ("These rules should be construed so as to administer every proceeding fairly, eliminate unjustifiable expense and delay, and promote the development of evidence law, to the end of ascertaining the truth and securing a just determination.").
[110] Grossman et al., supra note 8, at 19.

Recognizing the problems posed by audiovisual evidence that is alleged to be AIM, we show how judges can be proactive in addressing admissibility challenges under the current Federal Rules of Evidence. In as much as our hypothetical deals with a civil trial in federal court, we suggest the use of pre-trial conferences under Fed. R. Civ. P. 26(f) (between the parties) and Fed R. Civ. P. 16 (with the court) to allow the parties to disclose their intention to proffer audiovisual evidence and to raise evidentiary challenges thereto so that the parties can seek discovery to obtain the relevant facts to address their competing views about the authenticity of the possibly AIM evidence.

We also suggest that judges schedule such an evidentiary hearing well in advance of trial, so that the challenging party can present the factual basis for their evidentiary challenge and the proponent of the evidence can respond. Finally, we suggest that judges rule on the admissibility of the potential AIM evidence by drawing on the factual record presented at the hearing while also asking the parties to address the potential applicability of Fed. R. Evid. 403 to exclude relevant evidence when it creates a risk of unfair prejudice to the opposing party, confusion of the issues, misleading the jury, or delay.

A. Pre-trial conferences pursuant to Federal Rules of Civil Procedure 26(f) and 16

There are two types of pre-trial conferences under the Federal Rules of Civil Procedure, which set the stage for the court to manage the AIM admissibility issues presented in the hypothetical: (i) the Rule 26(f) conference between the parties, and (ii) the Rule 16 conference with the court. These conferences serve largely administrative purposes leading up to trial and provide an opportunity for the parties to discuss their respective plans for discovery. These conferences also allow the parties and the court to determine, well before trial, the appropriate scope and timelines for discovery, including discovery to resolve any evidentiary challenges that will be made. The conferences also provide the court with an early indication of the types of evidence both parties intend to present and to identify any related evidentiary challenges, including the assertion that any evidence is fake AIM.

Fed. R. Civ. P. 26(f) requires that "the parties must confer as soon as practicable—and in any event at least 21 days before a scheduling conference is to be held or a scheduling order is due under Rule 16(b)."[111] Notably, Rule 26(f)(1) provides an exception for the court to order otherwise, [112] but delay is inadvisable in most circumstances involving extensive discovery or complex evidentiary issues, such as those involving AIM. The court has considerable flexibility to adjust the timing of conferences, submissions by the parties, and exchanges of discovery materials, including information that the parties intend to use to support their claims and defenses.

During the Rule 26(f) conference, Connie will likely discuss the basis for her Voting Rights Act and defamation claims, and Eric will likely raise his related defenses. Both parties will raise the audiovisual evidence that they are likely to use to support their respective claims and defenses. This will serve as an early indication of potential admissibility challenges and will likely also trigger additional discovery requests for corroborating evidence to support each of their positions.

The parties are required to prepare a discovery plan, which among other things, calls on them to agree on the timing for initial disclosures under Fed. R. Civ. P. Rule 26(a), areas where discovery is needed, and when such discovery should be completed.[113] Initial disclosures include the production or description of electronically stored information (ESI) that will be used by the parties to support their claims and defenses (other than for

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[111] FED. R. CIV. P. 26(f)(1).

[112] Id.

[113] FED. R. CIV. P. 26(f)(3).

impeachment), which in turn must be made within 14 days of the initial Rule 26(f) conference.[114] Therefore, in connection with their initial disclosures Connie and Eric would be required to disclose the existence and location, or produce copies, of the video and audio recordings that they intend to use at trial, including those that are alleged to be fake AIM.

In most cases, the court should schedule one or more pretrial conferences with the parties to establish "early and continuing control so that the case will not be protracted because of lack of management."[115] The court's scheduling order will outline deadlines for Connie and Eric to disclose the nature of the evidence that supports their claims and defenses and should also outline any deadlines to challenge such evidence and seek additional discovery to support such a challenge. During the conference, the judge (undoubtedly alerted to the existence and importance of the audiovisual evidence from having read the allegations in the pleadings) can ask both parties if they intend to challenge the other's introduction of audiovisual evidence on the grounds that it is fake AIM. At this point, both parties would have already had a chance to confer with each other and should be aware of the possibility of challenges to each other's introduction of audiovisual evidence.

Connie will attempt to satisfy her burden of showing that Eric and his supporters knowingly published false and defamatory statements about her by publishing the allegedly fake videos and audio of her. Eric will challenge Connie's introduction of the audio conversation between John Doe and Eric, which allegedly supports Connie's allegation that the two coordinated the publication of false and defamatory statements about Connie. Connie will also introduce the recording from three years prior of Eric speaking to a staffer about the possibility of using deepfakes in a senate campaign, which Eric will challenge as

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[114] FED. R. CIV. P. 26(a)(1)(A)(ii); see also FED. R. CIV. P. 26(a)(1)(C).
[115] FED. R. CIV. P. 16(a)(2).

fake. Both parties will seek additional discovery to support their admissibility challenges, and the judge's scheduling order should include a deadline for completion of such discovery and the filing of motions to exclude evidence.[116] The court should set an evidentiary hearing date to rule on admissibility challenges.[117] The hearing should allow both parties "to develop the facts necessary to rule on the admissibility of the challenged evidence."[118]

B. Developing a factual record

Both Connie and Eric will use various discovery tools available to them under the Federal Rules of Civil Procedure to establish a factual basis to support the introduction of their own audio and audiovisual evidence and to challenge the evidence that is detrimental to their claims. Connie's goal will be to find corroborating evidence to show that the audio and video recordings of her and at election sites are fake AIM. Similarly, Eric will try to establish that the audio and video recordings are genuine and accurately reflect the events they purport to memorialize. The reverse is true for the case of the audio recording of the conversation between Eric and John Doe and Eric and his staffer three years prior.

Connie can use several different tools to establish a factual record for the evidentiary hearing. One approach would be to supply corroborating evidence suggesting that the audio and video recordings are fake. She can support this contention with alibi testimony or geolocation data showing that she was not at the location suggested at the time the videos and audio were allegedly recorded. For instance, evidence that places her at a different location at the time the video was recorded, as memorialized by its metadata, would be particularly helpful to her in supporting her authenticity challenge against the introduction of Eric's evidence.

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[116] See Grossman et al., supra note 8, at 15.
[117] See id. at 16.
[118] Id.

She can also seek to introduce expert testimony or evidence from deepfake detection (DD) tools to lend credibility to her arguments that the evidence in question is not authentic (keeping in mind the likely difficulty of showing that the DD tool used is valid and reliable). Connie can also subpoena Eric's phone records to establish a connection between him and John Doe to lend further credibility to her argument that the conversation indicating collusion between the two of them was genuine since the telephone records show the two men speaking at the time suggested by the metadata of the recording.

Similarly, Eric will try to establish that the incriminating videos of Connie with the Chinese embassy official are authentic. He might try to subpoena photos of the two together at other times and places. Eric will also try to find witnesses to authenticate Connie's voice in the purported audio recording of her soliciting bribes. He may subpoena Connie's phone records and bank statements to try to establish connections between Connie and the foreign agents with whom she is alleged to have connections. Eric may also try to depose Connie's close aides and campaign officials to establish a relationship between Connie and the Chinese embassy official she is seen with in the compromising video. If Eric can develop adequate corroborating evidence to show that Connie had a relationship with the Chinese embassy official, or that shows her at the locations at the time when the video was alleged to have been recorded, he will be able to make a strong argument in favor of the authenticity of the audio and video evidence. Like Connie, Eric likely will also make use of the results of AIM DD tools and expert testimony to argue that the audiovisual evidence is authentic, although given questions about the validity and reliability of deepfake detectors, the court will need to closely scrutinize any such evidence and the experts who offer it.

Finally, it is inevitable that both Connie and Eric will retain experts to support their positions. This will result in expert disclosure of their opinions, and their factual bases, materials reviewed, past testimonial experience, and publications,[119] and almost certainly their depositions.[120] When highly technical and specialized evidence is central to the case, it also can be expected that Connie and Eric will assess whether they believe they can exclude all or important portions of the other's experts' testimony, by filing *Daubert*[121] motions challenging the qualifications, factual sufficiency, methodology, and conclusions of the opposing experts.

C. Evidentiary Hearing

1. Scheduling

Trial judges should schedule an evidentiary hearing well in advance of trial to allow both parties ample opportunity to develop a factual record and to challenge the opposing parties since the ultimate resolution of these issues will likely play a vital role in the disposition of the litigation.[122] Both Eric and Connie need to show that the audiovisual evidence they are introducing meets the evidentiary requirements of both relevance and authenticity. Eric will introduce the incriminating audio and video evidence linking Connie to the Chinese embassy official and to the individuals from whom she is alleged to have solicited bribes. Connie will introduce the audio recording between Eric and John Doe and Eric and his staffer from three years prior. Eric will object that the audio recordings are fake AIM.

2. The Judge's Ruling on the Evidentiary Issues

After having heard all the evidence presented by Connie, Eric, John Doe, and PoliSocial, the judge will need to evaluate that evidence and rule on the contested issues.

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[119] FED. R. CIV. P. 26(a)(2).
[120] FED. R. CIV. P. 30.
[121] Daubert v. Merrell Dow Pharm., Inc., 509 U.S. 578 (1993); see also FED. R. EVID. 702.
[122] See Grossman et al, supra note 8, at 16.

As previously noted, this ruling (whether made orally "from the bench" or in writing) should be as factually specific and legally comprehensive as possible, both to guide the future conduct of the trial, and to provide any reviewing appellate court with a clear explanation of what the ruling is, and why.[123] We will focus first on the issues Connie likely will raise, then those by Eric, John Doe, and PoliSocial.

a. Connie's arguments that the audiovisual evidence of her relationship with the Chinese embassy official, her soliciting money, and her constituents stuffing ballot boxes are deepfakes

Reduced to its essentials, Connie will argue that the audiovisual evidence showing her illicit relationship with the Chinese official, her solicitation of money, and her constituents stuffing ballot boxes (collectively, "the Audiovisual Evidence") are deepfakes, that the events they purport to show did not occur, and that Eric, John Doe, and PoliSocial are responsible for disseminating them to the public, thereby defaming her. What is unique about Connie's position, however, is that she will *not* seek to exclude this evidence. Rather, she must introduce it to prove the falsity of its contents to demonstrate defamation.

In this instance, the judge will find that relevance is easily established. The audiovisual evidence is essential to prove key elements of Connie's defamation claim. Because the Audiovisual Evidence is relevant and has been challenged as fake AIM, the judge will need to assess the evidence Connie proffered during the hearing to show it is a deepfake. Although deepfake technology is rapidly evolving and at the moment it can be nearly impossible to determine if deepfakes are legitimate or not, it is nonetheless likely that Connie will call on an expert to testify that the audiovisual evidence is fake. This will require the judge to evaluate the Fed. R. Evid. 702 factors, as further amplified by the

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[123] FED. R. EVID. 103(C).

Daubert factors.[124] Importantly, as the amendments to Rule 702 from December 1, 2023 make clear, the judge must find that Connie has met her burden by a preponderance of the evidence before admitting her expert's testimony.[125]

The judge will first assess whether Connie's expert has sufficient knowledge, training, education, and experience to testify, and that that testimony will be helpful to the jury in deciding the case.[126] Assuming Connie has hired a legitimate expert, the judge will have little difficulty deciding that the expert is qualified and that their evidence will be helpful to the jury. Next, Fed. R. Evid. 702 requires Connie to demonstrate (again, by a preponderance) that her expert considered sufficient facts or data to support their opinions, that the methodology they used to reach their opinions was reliable, and that those methods and principles (themselves reliable) were reliably applied to the facts of the case.[127]

With regard to the reliability prongs, the judge will be guided by the *Daubert* factors: whether the methodology used by the expert in reaching their opinions has been tested; if so, whether there is a known error rate associated with the methodology; whether the methods and principles relied on by Connie's expert are generally accepted as reliable by other experts in the same field; whether the methodology used by Connie's expert has been

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[124] See 509 U.S. 578 at 591–95; see also FED. R. EVID. 702 advisory committee notes to 2000 amendments ("Daubert set forth a non-exclusive checklist for trial courts to use in assessing the reliability of scientific expert testimony. The specific factors explicated by the Daubert Court are (1) whether the expert's technique or theory can be or has been tested—that is, whether the expert's theory can be challenged in some objective sense, or whether it is instead simply a subjective, conclusory approach that cannot reasonably be assessed for reliability; (2) whether the technique or theory has been subject to peer review and publication; (3) the known or potential rate of error of the technique or theory when applied; (4) the existence and maintenance of standards and controls; and (5) whether the technique or theory has been generally accepted in the scientific community.")

[125] FED. R. EVID. 702.

[126] FED. R. EVID. 702.

[127] Id.

subject to peer review; and whether there are standard accepted procedures for using the methodology, and whether the expert complied with them.[128]

The judge will also consider any expert testimony offered by Eric, John Doe, and PoliSocial to undermine Connie's expert in deciding whether to allow Connie's expert to testify to the jury. In this regard, the judge's focus is not on the *correctness* of Connie's expert's opinions, but rather on whether they were qualified, considered sufficient facts, used reliable methodology, reliably applied it to the facts of the case, and complied with any generally accepted protocols related to the DD methodology selected.[129] The judge will evaluate the defendants' expert's testimony the same way in which they evaluate Connie's expert's.

If the judge is persuaded that Connie and the defendants have met their foundational requirements by a preponderance of the evidence, they both will be allowed to testify at trial, and it will be up to the jury to decide which expert's testimony it accepts (if any). It should be obvious that Connie and the defendants will be wise to retain qualified experts who carefully comply with the *Daubert* and Rule 702 factors particularly since current DD methods may readily be challenged. If the judge concludes that either (or both) experts failed to meet these requirements, the judge will exclude them from testifying at trial.

Finally, it is worth noting that Connie's and the defendants' experts will be selected by them, and they are not likely to offer an expert that does not express opinions consistent

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[128] See FED. R. EVID. 702 advisory committee notes to 2000 amendments, which describes additional factors (has expert accounted for any alternative explanations, does the methodology used by the expert exist for a purpose other than litigation, and if so, was the same degree of rigor used by the expert for litigation purposes as they would use for a non-litigation purpose, are there any unjustified "analytical leaps" the expert made that are not justified by the facts considered and the methodology used).
[129] See 509 U.S. 578 at 591–95.

with their litigation positions. This means that in real life, the parties' experts will not be testifying as independent technologists or scientists, but more realistically, as paid advocates. Since the cost of the judge appointing a court expert under Fed. R. Evid. 706 is typically prohibitive, and the court has no funds to do so on its own, the judge may find themself in "a battle of wits unarmed"[130]—lacking sufficient knowledge of the technical issues to evaluate all the Fed. R. Evid. 702 and Daubert factors effectively (including the particular DD methods applied). The best way for the judge to avoid this is to make it clear during the pretrial conference what the judge will expect the experts to address during their testimony, and the materials they will rely on to support it, and require that the materials be produced to the judge well ahead of the hearing, so that the judge will have sufficient time to review the materials in advance of the hearing and be as well prepared as they can be to question the experts during their testimony.[131] Some judges have held "science days" in which they were able to learn from the experts in a more informal setting[132] and we encourage that practice in the case of expert testimony concerning DD technology.

b. The Defendants' Motion to Exclude incriminating audio evidence.

Defendants will argue that the incriminating audio evidence (of Eric and John Doe, and the recording of Eric and his staffer three years prior) raises the very issues we addressed above regarding conditional relevance; the judge's role under Fed. R. Evid. 104(a); the jury's role as decider of contested facts under Fed. R. Evid. 104(b); and,

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[130] https://checkyourfact.com/2019/08/13/quote-shakespeare-battle-wits-unarmed/

[131] See, e.g., FED. R. EVID. 614(b).

[132] See, e.g., [Ozempic] Case Management Order No. 5 scheduling a "Science Day" on June 14, 2024, during which the parties "will, in an objective format, provide the Court with an overview of certain medical and scientific issues … ." https://www.aboutlawsuits.com/wp-content/uploads/2024-04-26-Order.pdf

especially, Fed. R. Evid. 403, which nonetheless allows the judge to exclude relevant evidence if its probative value is substantially outweighed by the danger of unfair prejudice.

Preliminarily, it will be Connie's burden to introduce evidence sufficient for the judge to conclude that the jury reasonably could find by a preponderance of evidence (more likely than not) that the incriminating audio recordings are authentic. And the defendants will have the burden of introducing evidence that it is not Eric's or John Doe's voice on the recordings—it is fake AIM. The judge will consider all the evidence submitted by Connie and the defendants. If the judge determines that Connie failed to meet her burden, then the recording will not be found to be authentic, and therefore not relevant, and it will be excluded. But assuming that Connie's evidence is sufficient for the jury to find that the recording reflects Eric and John Doe's voices, by a preponderance of the evidence, then the jury will hear the evidence, unless the judge finds under Fed. R, Evid. 403 that its introduction will result in unfair prejudice that substantially outweighs its probative value.

While the Federal Rules of Evidence generally disfavor judicial gatekeeping of evidence at the admissibility stage, there are nonetheless instances where exclusion of deepfake evidence is likely warranted under Rule 403. Ultimately, the text of Rule 403 provides trial judges with explicit, albeit limited, gatekeeping power to exclude evidence that is relevant, but whose probative value is substantially outweighed by its potential for unfair prejudice. We can represent the Rule 403 analysis on a continuum for each evidentiary situation presented. On one end of the continuum, the potential for unfair prejudice is at a maximum and probative value is at a minimum, leading to exclusion of the evidence. On the other end of the continuum, the potential for unfair prejudice is at a minimum and probative value is at a maximum, leading to admission of the evidence. We can use this continuum to analyze the Rule 403 balancing test for the examples in our hypothetical.

The audio recording of Eric discussing the use of deepfakes from a prior election campaign nearly three years ago likely meets the relevance and authenticity requirements because it arguably supports Connie's claims. Eric will argue that the audio relating to the prior election should be excluded under Fed. R. Evid. 404(b) to the extent that it is being used as character evidence to suggest that he engaged in the same conduct in the current election campaign.[133] Connie can rebut by arguing that it should be permitted under Fed. R. Evid. 404(b)(2) because it proves that Eric had the knowledge, capability, and plan to make and use deepfakes.[134]

Additionally, Eric will argue that this audio recording is fake AIM and will attempt to present evidence to support his case. But it might be difficult to find alibi evidence, especially if it is not clear when the recording was made. In addition, Eric will counter that even if authentic, the evidence of him discussing deepfakes in a prior election does not necessarily mean that he used the deepfakes in that campaign either. For one, the audio simply captures him talking about deepfake technology generally and there is no specific discussion of using deepfakes against his opponent. He would further dispute the implication that such evidence relating to a state senate election proves that he would use deepfakes in a future presidential campaign.

With regard to the recording between Eric and a staffer three years prior, Eric can make a strong argument that the audio recording should be excluded under Rule 403 because its probative value is relatively low and is substantially outweighed by being highly unfairly prejudicial. The audio, while relevant, has lower probative value because it relates

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[133] See FED. R. EVID. 404(b)(1) ("Evidence of any other crime, wrong, or act is not admissible to prove a person's character in order to show that on a particular occasion the person acted in accordance with the character.")

[134] See FED. R. EVID. 404(b)(2) ("This evidence may be admissible for another purpose, such as proving motive, opportunity, intent, preparation, plan, knowledge, identity, absence of mistake, or lack of accident.").

to a prior election, not facts at the heart of this case. Moreover, it is likely to be unfairly prejudicial to the defendant because admitting it will predispose the jury to draw conclusions on his actions based on prior acts and Eric's character, likely even if the jury agrees with Eric that it is fake. Both *Johnston* and *Huddleston* support the judge exercising authority to exclude evidence of prior acts and convictions when the probative value is low and unfair prejudice is high.[135]

The judge's ruling on the audio recording of the conversation between John Doe and Eric will be a closer call, falling somewhere in the middle of our continuum. Each of these decisions is highly fact dependent, of course, and a real situation will involve rich facts that are developed by the parties through discovery. In our hypothetical, the audio of John Doe and Eric, if authentic and relevant, is a "smoking gun" supporting Connie's claims that the defendants created and published the explosive audio and videotapes that defamed her. But, at the same time, it is devastatingly prejudicial to the defendants, and arguably unfairly prejudicial if it is likely fake and sways the jury nonetheless. The judge will be especially careful to look at the totality of facts that show that it was John Doe on the tape and other evidence developed and presented by Eric and Connie. Are there credible testifying witnesses who are familiar with Eric and John Doe's voices? Does geolocation information place them at the place and at the time where the recording was made? Are there any other corroborating facts to support Connie's position that it is Eric and John Doe speaking? What is the nature and quality of Eric's and John Doe's evidence that it was not them? A mere denial? A credible alibi including witnesses that could establish that neither could possibly have made the recording at the time and place where Connie claims it was made?

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[135] Johnson v. Elk Lake Sch. Dist., 283 F.3d 138, 155 (2002). Huddleston v. United States, 485 U.S. 681, 687 (1988).

For instance, if Eric has strong evidence supporting his contention that the voices on the recording could not possibly have been his or John Doe's, he can present a stronger argument for exclusion, that unfair prejudice substantially outweighs the probative value of the audio. Such evidence could be established in the form of alibis placing him and John Doe at different locations at the time the audio was purportedly recorded. An example of such a scenario might be that either Eric or John Doe was unconscious or undergoing surgery at the time of the recording and thus convincing evidence corroborates that they could not have been the subjects of the audio recording. On unfair prejudice, Eric could argue that the contents of the recording were inflammatory because they show him using disparaging remarks towards his opponent. Eric's alleged quip suggesting that women are not fit to be president arguably bolsters his argument. He can argue that the audio should be excluded because it would leave a lasting negative impression on the jury in a way that could lead them to rule based on their emotions rather than the merits of the case, even if the jury finds that the audio is likely fake. Depending on the specific facts, the better argument could go either way, although the parties and court must always consider the preference for admitting evidence and the requirement that unfair prejudice must "substantially outweigh" probative value to exclude relevant evidence under Rule 403.

Finally, what if Connie were to seek to admit an audio recording of Eric directing John Doe to create deepfakes of Connie in the upcoming election? If Eric objects that the recording is itself a deepfake, could he make a colorable argument for exclusion under Rule 403? Such evidence would be highly probative because it relates to the current matter, not an earlier election. Unlike the evidence relating to a previous election, this audio would be at the heart of the case. Eric could argue that the jury will find that it is a deepfake but nevertheless be swayed by the audio, pointing to the research showing the power of audiovisual evidence, even that which a jury determines is fake. Is this unfair prejudice, and does it substantially outweigh the probative value of such an audio recording? Alone, almost certainly not, especially if Connie produces any corroborating evidence, such as geolocation evidence and phone records. If Eric presents nothing more than the assertion that the audio recording is AIM, a serious concern would be that by deeming it inadmissible, the judge would be supplanting the jury as fact finder. Additionally, Eric will have every opportunity to take discovery to demonstrate that the audio is AIM, such as by showing that Eric and John Doe were not at the locations suggested by the audio. Eric can also hire an expert witness and take other steps to attack the chain of custody and other indicators of the genuineness of the audio recording. If Eric cannot produce strong evidence that the audio is fake, he will have only a weak argument that the audio recording is unfairly prejudicial. In scenarios like this one, there is not a strong argument to exclude the alleged AIM under Rule 403, although we emphasize that this is a fact dependent inquiry. In the right case, the parties will be able to develop the record and present arguments that could tip the balance in favor of exclusion under Rule 403.

VII. ALTERNATIVE APPROACHES: RULE CHANGE PROPOSALS

Given the complexities and challenges presented by AIM, there are growing calls to amend the Federal Rules of Evidence. In this section, two approaches to modifying the rules are discussed. In thinking about such proposals, it is important to consider that rule changes are infrequent and often take years to materialize.

A. Burden shifting approach towards admissibility

Two authors of this paper (Grimm and Grossman) have proposed a modification to Rule 901 for possible deepfakes.[136] They suggest a separate rule because of the increasing

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[136] https://www.uscourts.gov/sites/default/files/2024-04_agenda_book_for_evidence_rules_meeting_final_updated_5-8-2024.pdf. See also Symposium On

difficulty of differentiating between authentic audiovisual evidence and fabricated or altered audiovisual evidence. This is particularly true in instances where, as in our proposed hypothetical, one party introduces audiovisual evidence and the other challenges its admissibility on the grounds that it is AIM. Under the existing Rules, the proponent of evidence challenged as AIM might choose to authenticate an audio recording under Rule 901(b)(5) (opinion as to voice) or Rule 901(b)(3) (comparison of evidence known to be authentic with other evidence the authenticity of which is questioned). These are easier routes to authentication than Rule 901(b)(9), which focuses on evidence generated by a "system or process."

Grimm and Grossman propose a new rule 901(c):

> 901(c): *Potentially Fabricated or Altered Electronic Evidence.*
> If a party challenging the authenticity of computer-generated or other electronic evidence demonstrates to the court that it is more likely than not either fabricated, or altered in whole or in part, the evidence is admissible only if the proponent demonstrates that its probative value outweighs its prejudicial effect on the party challenging the evidence.

The proposed rule does not use the word "deepfake," because it is not a technical term. Instead, the proposed rule describes the evidence as being either computer-generated (which encompasses AI-generated evidence) or electronic evidence, which encompasses other forms of electronic evidence that may not be AI generated (such as digital photographs, or digital recordings).

The proposed rule puts the initial burden on the party challenging the authenticity of computer generated or electronic evidence to make a showing to the court that it is more likely than not either fabricated or altered in whole or part. This standard is similar to the

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Scholars' Suggestions For Amendments, And Issues Raised By Artificial Intelligence (https://fordhamlawreview.org/issues/symposium-on-scholars-suggestions-for-amendments-and-issues-raised-by-artificial-intelligence/). Daniel J. Capra, Deepfakes Reach the Advisory Committee on Evidence Rules, 92 Fordham L.R. 2491.

showing required by the proponent of scientific, technical, or specialized evidence under newly revised Rule 702. It requires the challenging party to produce evidence to support the claim that it is fabricated or altered. Mere conclusory allegations are insufficient. If the challenging party makes the required showing, the burden shifts to the proponent of the challenged evidence to show that its probative value outweighs its prejudicial effect on the party challenging the evidence. This is the same showing required by Rule 609(a)(1)(B) (regarding attacking character for truthfulness by introducing evidence of a criminal conviction), and is a lesser showing than a "reverse balancing" test such as used in Rule 609(b)(1) (regarding introduction of a criminal conviction from more than 10 years in the past) or Rule 703 (regarding introducing to the jury inadmissible facts or data relied upon by an expert).

If the party objecting to the evidence as being AIM fails to make the showing to the court that it more likely than not is fabricated or altered, then the court will allow the proponents evidence and the opposing party's evidence to go to the jury under Rule 104(b). But, if the opposing party makes the required showing and the proposing party fails to show that the probative value of the challenged evidence outweighs its prejudicial effect on the challenging party, the court will exclude the evidence under Rule 104(a).

B. Expanding judicial gatekeeping

Rebecca Delfino proposes yet another formulation of Rule 901(c) that "would expand the gatekeeping function of the court by assigning the responsibility of deciding authenticity issues solely to the judge."[137] The primary function of the proposed rule is to

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[137] See Delfino, supra note 8, at 341. Delfino's proposed version of the rule is "901(c). Notwithstanding subdivision (a), to satisfy the requirement of authenticating or identifying an item of audiovisual evidence, the proponent must produce evidence that the item is what the proponent claims it is in accordance with subdivision (b). The court must decide any question about whether the evidence is admissible."

recategorize the authentication of audiovisual evidence from conditional relevance under Rule 104(b) to relevancy under Rule 104(a).[138] Such an expansion of the judge's role in determining admissibility is justified primarily by the nature of the threat that deepfake evidence poses.[139] Delfino argues that such forms of evidence are "technically complex and highly prejudicial to jury deliberations."[140]

Of particular concern is that deepfakes are intentionally designed to deceive and alter the perceptions of the viewer. Add to this the problem that deepfakes are increasingly sophisticated enough that they are virtually undetectable, even by experts. Given that authenticating deepfakes will likely exceed the jury's capabilities, Delfino argues for expanding the judge's role "as the preliminary factfinder to protect the integrity of the jury's deliberations."[141] As Grossman, Grimm, and Brown noted, a change that "eliminate[s] the role of the jury in determining the authenticity of digital and audiovisual evidence in response to the appearance of deepfakes . . . would involve a substantial departure from the current evidentiary framework . . . making it infeasaible as a practical solution."[142] The Grimm-Grossman proposal aims to address the same concerns without veering as far from longstanding legal precedent.

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[138] Id.

[139] Id. at 342.

[140] Id. at 345.

[141] Id. at 346. "Thus, [deepfake] evidence presents the same risk as other highly prejudicial or technical evidence, where case law and commentators have recognized that judges should act as the preliminary factfinder to protect the integrity of the jury's deliberations. The reality of deepfakes requires that we acknowledge the limits of our trust in the jury."

[142] Grossman et al, supra note 8, 16.

At its most April 19, 2024, meeting, however, the Advisory Committee on the Federal Rules of Evidence considered both of these proposals, among others,[143] and determined not to make any rules changes at this time.[144]

VIII. CONCLUSION

Given the ease with which anyone can create a convincing deepfake, courts should expect to see a flood of cases in which the parties allege that evidence is not real, but AI generated. Election interference is one example of a national security scenario in which deepfakes have important consequences. There is unlikely to be a technical solution to the deepfake problem. Most experts agree that neither watermarks nor deepfake detectors will completely solve the problem, and human experts are unlikely to fare much better. Courts will have no option, at least for the time being, other than to use the existing Federal Rules of Evidence to address deepfakes. The best approach will be for judges to proactively address disputes regarding alleged deepfakes, including through scheduling conferences, permitted discovery, and hearings to develop the factual and legal issues to resolve these disputes well before trial.

Even as several scholars propose to amend the Federal Rules of Evidence in recognition of the threat posed by deepfake evidence, such changes are unlikely in the near future. Meanwhile, trial courts will require an interim solution as they grapple with AIM evidence. Rule 403 will play an important role, as the party against whom an alleged deepfake is proffered may be able to make a compelling argument that the alleged deepfake

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[143] Daniel J. Capra, Deepfakes Reach the Advisory Committee on Evidence Rules, 92 Fordham L.R. 2491. https://www.uscourts.gov/sites/default/files/2024-04_agenda_book_for_evidence_rules_meeting_final_updated_5-8-2024.pdf

[144] https://www.reuters.com/legal/transactional/us-judicial-panel-wrestles-with-how-police-ai-generated-evidence-2024-04-19/. https://www.uscourts.gov/sites/default/files/2024-06_agenda_book_for_standing_committee_meeting_final.pdf (pg 110-112).

should be excluded because the probative value of the alleged deepfake is substantially outweighed by the potential for unfair prejudice because social science research shows that jurors may be swayed by audiovisual evidence even when they conclude that it is fake. This argument will be strongest when the alleged deepfake will lead the jury to decide the case based on emotion rather than on the merits.

September 25, 2024

The Honorable Harvey Brown
Supreme Court Advisory Committee
10940 W. Sam Houston Pkwy N.,
Suite 100
Houston, TX 77064

RE: Increasing The Transparency Of Third-Party Litigation Funding

Dear Judge Brown:

We are writing on behalf of the Texas Civil Justice League ("TCJL"), the U.S. Chamber of Commerce Institute for Legal Reform ("ILR"), and Lawyers for Civil Justice ("LCJ") in connection with the subject of third-party litigation funding, or "TPLF," which is currently one of the subjects being studied by the Supreme Court Advisory Committee for potential rulemaking. The purpose of this letter is two-fold: (1) to express the undersigned's strong support for the adoption of a disclosure requirement for TPLF arrangements in all civil cases in Texas state court; and (2) to respond to the International Legal Finance Association's ("ILFA") recent letter (the "ILFA Letter" or the "Letter") opposing such a proposal.

TCJL is the nation's oldest and largest state legal reform organization. Its members include hundreds of corporate businesses of all sizes: law firms, professional and trade associations, health care providers, and individuals. For more than three decades, TCJL has represented the common interests of Texas businesses and individuals in achieving an accessible, efficient, and impartial civil justice system. TCJL has pursued a broad civil justice reform agenda and works to assure that regulatory and administrative processes and procedures are fair, equitable, and efficient and do not impose undue burdens or excessive penalties on Texas businesses.

A program of the U.S. Chamber of Commerce (the "Chamber"), ILR's mission is to champion a fair legal system that promotes economic growth and opportunity. The Chamber is the world's largest business federation, representing the interests of millions of businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations, so it is wholistically dedicated to promoting, protecting, and defending America's free enterprise system.

LCJ is a national coalition of corporations, defense trial lawyer organizations, and law firms that advocates for excellence and fairness in the civil justice system. Since 1987, LCJ has actively endorsed rule reforms that (1) promote balance in the civil justice system; (2) reduce the costs and burdens associated with litigation; and (3) advance predictability and efficiency in litigation.

TPLF is a rapidly growing business model in which non-parties invest in litigation by paying money to a plaintiff or his/her counsel in exchange for a contingent interest in any proceeds from the lawsuit. Virtually all TPLF activity in U.S. and Texas courts occurs in secrecy because there is no generally applicable statute or rule requiring disclosure.[1] ILFA's Letter does not dispute either reality. Instead, it claims on the very first page that ILFA "does not oppose reasonable disclosure requirements."[2] That statement is simply not credible given that ILFA has consistently opposed such proposals.[3] Indeed, ILFA devotes the bulk of its Letter to perpetuating a series of claims that the funding industry has repeatedly used to ***resist*** disclosure proposals, including that: (1) the existence of TPLF in a lawsuit is irrelevant to the claims and defenses; (2) funders do not exercise any control or influence over the litigation they invest in; (3) judges approach the question of disclosure differently; (4) foreign investment in litigation is without any risk; (5) disclosure of TPLF arrangements violates the work-product doctrine; and (6) TPLF disclosure threatens to chill speech and violate the First Amendment. As explained below, these claims are either untrue or actually highlight the need for disclosing TPLF arrangements in Texas state courts.

I. WHETHER TPLF IS RELEVANT TO A PARTY'S CLAIMS OR DEFENSES MISSES THE POINT.

One of the first claims ILFA makes in opposing a TPLF disclosure requirement is that "[t]he facts surrounding how a party finances its litigation . . . are simply not relevant to the merits of the litigation in the vast majority of cases."[4] This argument fundamentally misapprehends the purpose of a TPLF disclosure requirement.

In 1970, the Federal Advisory Committee on Civil Rules (the body responsible for overseeing changes to the Federal Rules of Civil Procedure) confronted the question whether defendants should be required to disclose insurance agreements that may pertain to a lawsuit. The Committee observed that many courts had rejected discovery requests for such agreements, often "reason[ing] from the text of Rule 26(b) that it permits discovery only of matters which will be admissible in evidence or appear reasonably calculated to lead to such evidence."[5] The

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[1] *See* James Anderson, *Is Increased Transparency into Litigation Financing on the Horizon?*, National Law Review (Jan. 15, 2020), https://www.natlawreview.com/article/increased-transparency-litigation-financing-horizon.

[2] ILFA Letter at 1.

[3] *See, e.g.*, Statement for the Record, International Legal Finance Association, House Judiciary Subcommittee on Courts, Intellectual Property, and the Internet, "The U.S. Intellectual Property System and the Impact of Litigation Financed by Third-Party Investors and Foreign Entities" (June 12, 2024), https://docs.house.gov/meetings/JU/JU03/20240612/117421/HHRG-118-JU03-20240612-SD004.pdf (ILFA statement to Congress arguing that mandatory "disclosure would be highly prejudicial and create an unlevel playing field" and "would allow opposing parties to weaponize financing to their advantage"); Statement for the Record, International Legal Finance Association, United States House of Representatives Committee on Oversight and Accountability (Sept. 13, 2023), https://www.congress.gov/118/meeting/house/116346/documents/HHRG-118-GO00-20230913-SD016.pdf (ILFA statement to congress arguing that "forced" (i.e., mandatory) disclosure of TPLF is "highly politicized" and supported by "specious arguments"); ILFA, Comments Regarding Proposed New Local Civil Rule 7.1.1, United States District Court for the District of New Jersey, https://uploads-ssl.webflow.com/5ef44d9ad0e366e4767c9f0c/60aeece4a69ea26e52b1d847_2021%2005%2010%20ILFA%20Letter%20to%20DNJ.pdf (opposing disclosure rule in District of New Jersey).

[4] ILFA Letter at 1.

[5] Fed. R. Civ. P. 26 advisory committee's notes to 1970 amendment.

Committee noted that those courts "avoid[ed] considerations of policy, regarding them as foreclosed."[6] The Committee ultimately concluded that the Rule 26(b) "relevancy" analysis was beside the point and that policy considerations dictated that insurance agreements should be subject to a mandatory disclosure requirement—that defendants should be required to produce them without need for a discovery request.[7]

Importantly, Texas later reached the same conclusion by adding subsection (b)(7) to Rule 194.2, requiring automatic production of "any indemnity and insuring agreements" at the outset of a lawsuit.[8] Echoing the federal rule's drafters, the Supreme Court has explained that mandatory discovery of insurance agreements "***regardless of their relevance to the underlying suit's merits*** . . . 'enable[s] counsel for both sides to make the same realistic appraisal of the case, so that settlement and litigation strategy are based on knowledge and not speculation.'"[9]

The same logic supports the disclosure of TPLF agreements. Like the disclosure of insurance agreements, sharing TPLF agreements will provide some sense of the plaintiffs' litigation resources. Further, like insurance agreements, the TPLF agreement will provide insights into the role the third-party player (that is, the TPLF entity) may play in any settlement negotiations. Accordingly, disclosure of the actual funding agreements would complement the existing insurance disclosure requirement and enable courts and defendants to more accurately evaluate settlement prospects and to better calibrate settlement initiatives.

Accordingly, and notwithstanding any decisions on the "relevancy" of such information, the Supreme Court should adopt a mandatory disclosure rule regarding TPLF agreements, just as it did regarding insurance agreements. In particular, the undersigned propose amending Rule of Civil Procedure 194.2(b) by adding TPLF agreements to the list of information that must be produced in initial disclosures. In particular, the undersigned propose adding a new subsection (13) stating the following:

(i) the identity of any commercial enterprise (other than counsel of record) that has a right to receive any payment that is contingent on the outcome of the civil action or a group of the actions of which the civil action is a part;

(ii) and produce to the court and each other named party to the civil action, for inspection and copying, except as otherwise stipulated or ordered by the court, any agreement creating a contingent right referred to in paragraph (i).

In short, contrary to the TPLF company arguments, the Committee clearly is not precluded from adopting on policy grounds a rule requiring mandatory disclosure of materials that are arguably not relevant under existing discovery rules.

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[6] *Id.*

[7] *Id.*

[8] Tex. R. Civ. P. 194.2(b)(7).

[9] *In re Dana Corp.*, 138 S.W.3d 298, 304 (Tex. 2004) (emphasis added) (citation omitted).

II. THERE IS MOUNTING EVIDENCE THAT FUNDERS EXERCISE CONTROL AND INFLUENCE OVER THE LITIGATION THEY SPONSOR, UNDERSCORING THE NEED FOR A MANDATORY DISCLOSURE RULE.

According to ILFA's Letter, funders are merely "passive investors"—i.e., they do not control or influence the litigation they choose to bankroll.[10] This statement mirrors the claims made by individual funders themselves, including Burford Capital (the world's largest funder), which has repeatedly represented that it "***do[es] not control strategy or settlement decision-making***."[11] However, this narrative is contradicted by several recent examples of actual TPLF agreements that have expressly ceded such authority to third-party investors.

Most notably, Sysco Corporation ("Sysco") filed a series of antitrust class actions against various poultry and meat suppliers that it financed with more than $140 million provided by Burford.[12] During the pendency of the TPLF arrangement, Burford demanded that the funding agreement be changed to give Burford the right to review and reject settlement offers, provided Burford's consent is not "unreasonably withheld."[13] Once Sysco began receiving settlement offers it found to be reasonable, Burford allegedly sought to obstruct further settlement negotiations, complaining that the amounts were too low.[14] Burford instituted proceedings to enjoin Sysco from finalizing settlements, and an arbitral panel granted an *ex parte* temporary restraining order in Burford's favor.[15]

Burford and Sysco eventually settled their dispute. Although most of the details of the settlement remain confidential, one aspect that was publicly disclosed is that Sysco agreed to assign its claims to an affiliate of Burford. The fact that Sysco had to assign its claims to a Burford affiliate just to extricate itself from lawsuits Burford insisted on prolonging raises

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[10] ILFA Letter at 10.

[11] *See* https://www.burfordcapital.com/how-we-work/with-law-firms/ (emphasis added); *see also, e.g.*, https://www.burfordcapital.com/insights/insights-container/byline-pli-legal-finance-post-covid/ ("If the matter wins, they can expect a meaningful share of the remaining damages, and if it loses, they keep any capital advanced, locking in a minimum outcome. In both scenarios, ***the company maintains control of its litigation***—and considerably more control over its finances.") (emphasis added); https://www.burfordcapital.com/insights/legal-finance-101/ ("Reported use of legal finance—also called litigation finance or litigation funding—has doubled in recent years, as companies and law firms increasingly recognize the benefits of gaining better control over legal budgets and risk ***without ceding control of litigation decision-making or settlement***.") (emphasis added); https://www.burfordcapital.com/insights/insights-container/how-do-law-firms-use-portfolio-finance/ ("[T]he use of legal finance generally does not alter control of decision-making or attorney-client relationships. Burford makes a portfolio deal directly with the firm, but Burford's role is that of a passive investor. Therefore, ***Burford does not control the litigation or settlement strategy and decision-making***, except when agreed to by our client.") (emphasis added); https://www.sec.gov/Archives/edgar/data/1714174/000110465920081137/filename1.htm ("Unlike in our legal finance business, where we are ***financing a client who retains decision-making authority in the litigation*** . . . .") (emphasis added).

[12] *In re Pork Antitrust Litig.*, MDL No. 3031, 2024 U.S. Dist. LEXIS 97801, at *5 (D. Minn. June 3, 2024).

[13] *See* Am. Petition to Vacate Arbitration Award ¶ 40, *Sysco Corp. v. Glaz LLC*, No. 1:23-cv-01451, ECF No. 18 (N.D. Ill. filed Mar. 20, 2023).

[14] *See id.* ¶¶ 30-40.

[15] *See id.* ¶¶ 41-58.

serious questions about the extent of Burford's control and influence over the actions. Indeed, the defendants in the underlying litigation mounted legal challenges to the substitution of the Burford affiliate as a plaintiff, and the assignment continues to be the subject of significant and ongoing litigation.

Notably, earlier this year, U.S. District Judge John Tunheim (D. Minn.) affirmed a magistrate judge's denial of the requested substitution, reasoning that it "threaten[ed] the public policy favoring the settlements of lawsuits."[16] As the court put it, "Sysco and Burford's conduct is precisely the kind of conduct of which courts are wary." The requested substitution "resulted from their attempt to resolve [a] dispute over whether" Sysco (the plaintiff) or Burford (the investor) "should ***control*** this litigation." While Judge Tunheim refused to "approve such conduct," other judges will have no way of even knowing whether such conduct is at play in their cases unless there is a mandatory requirement that TPLF arrangements (including their terms) be disclosed as a matter of course.

Importantly, the *Sysco* dispute is not an outlier; rather, it mirrors multiple other examples of funder control or influence over litigation. For example, in September 2023, Burford-backed litigants won a potentially $16 billion judgment against the government of Argentina. As a Burford representative put it, "[t]here is no aspect of this case, from ***strategy*** to minutiae, that did not involve an experienced Burford team spending many thousands of hours getting to this point."[17] The elaborate funding agreement utilized by Burford in class action litigation against Chevron in Ecuador also "provide[d] control to the Funders" through the "installment of 'Nominated Lawyers'"—lawyers "selected by the Claimants with the Funder's approval."[18] Similarly, in *Boling v. Prospect Funding Holdings, LLC*, the U.S. Court of Appeals for the Sixth Circuit concluded that the terms of the funding agreements involved in that matter "effectively g[a]ve Prospect [Funding Holdings, LLC (a TPLF entity)] substantial control over the litigation," including terms that "may interfere with or discourage settlement" and otherwise "raise[d] quite reasonable concerns about whether a plaintiff can truly operate independently in litigation."[19] And in *Gbarabe v. Chevron Corp.*, the funding agreement contained several key provisions that suggested Therium Litigation Funding IC, a Jersey-based litigation funder, sought to influence the course of the litigation, including one prohibiting the lawyers from engaging any co-counsel or experts without the funder's consent.[20]

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[16] *In re Pork*, 2024 U.S. Dist. LEXIS 97801, at *13.

[17] Burford Capital Statement on YPF Damages Ruling (Sept. 8, 2023), https://investors.burfordcapital.com/news/news-details/2023/BURFORD-CAPITAL-STATEMENT-ON-YPF-DAMAGES-RULING/default.aspx (emphasis added).

[18] Maya Steinitz, *The Litigation Finance Contract*, 54 Wm. & Mary L. Rev. 455, 472 (2012).

[19] 771 F. App'x 562, 579-80 (6th Cir. 2019).

[20] Litigation Funding Agreement, § 1.1, *Gbarabe v. Chevron Corp.*, No. 3:14-cv-00173-SI, ECF No. 186-4, 69-91 (N.D. Cal. filed Sept. 16, 2016). In a lawsuit filed in 2018, White Lilly, LLC, a TPLF entity, affirmatively asserted that it had the contractual right to exercise control over the litigation in which it had invested by, *inter alia*, requiring that specified counsel (who had an existing relationship with the TPLF company) serve as one of the plaintiff's counsel in the funded lawsuit. *See* Compl. ¶ 35, *White Lilly, LLC v. Balestriere PLLC*, No. 1:18-cv-12404-ALC (S.D.N.Y. filed Dec. 31, 2018). Notably, Bentham IMF—now Omni Bridgeway—specifically

(cont'd)

While TPLF agreements have largely remained secret, the handful of disputes between funders and the litigants they finance demonstrate that funders are ***not*** merely passive investors. Rather, they contract for—and often exercise—authority to control or influence (i.e., protect) their investments. A mandatory disclosure requirement in Texas would ensure that plaintiffs and their counsel are driving strategy and litigation decisions rather than third-party investors, who have no fiduciary obligations to the claimants and whose primary interest is maximizing their own profit.

III. INCREASING JUDICIAL, LEGISLATIVE, AND EXECUTIVE BRANCH CONCERNS ABOUT TPLF AND DISPARATE APPROACHES DEMONSTRATE WHY JUDGES NEED STANDARDIZED GUIDANCE TO STEER THEIR INQUIRIES.

ILFA further claims that federal courts have differing opinions on mandatory disclosure, and that only limited disclosure rules have been adopted.[21] But in so claiming, ILFA fails to grapple with the growing judicial, legislative, and executive branch concern regarding TPLF and the increasing consensus that transparency regarding this practice is necessary. And while there is no doubt that courts have taken varying approaches to the disclosure of TPLF funding agreements, that variability underscores why uniform disclosure rules are needed going forward.

First, while ILFA accuses TCJL and ILR of "overstat[ing] the current state of federal rules requiring disclosure,"[22] ILFA is the one that is misstating the state of play. It ignores significant examples of individual federal judges requiring basic TPLF disclosure either through their questioning of counsel or by court order. For example:

- Judge Yvonne Gonzalez Rogers of the U.S. District Court for the Northern District of California orally asked each attorney seeking a leadership position in the recently established social media addiction multidistrict litigation ("MDL") proceeding to divulge in open court whether he or she is using (or plans to use) TPLF.[23]
- Chief Judge Colm Connolly of the U.S. District Court for the District of Delaware issued a standing order requiring litigants to disclose whether their cases are being financed by TPLF, and whether there are any conditions tied to that funding (i.e.,

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contemplated funder control over litigation strategies in its 2017 "best practices" guide for U.S. matters, highlighting the importance of setting forth specific terms in TPLF agreements that give the funder authority to: "[m]anage a litigant's litigation expenses"; "[r]eceive notice of and provide input on any settlement demand and/or offer, and any response"; and participate in settlement decisions. Bentham IMF, Code of Best Practices (Jan. 2017).

[21] ILFA Letter at 1-5.

[22] *Id.* at 1.

[23] Hr'g Tr. 12:21-24, *In re Soc. Media Adolescent Addiction/Pers. Injury Prods. Liab. Litig.*, MDL No. 3047, ECF No. 84 (N.D. Cal. Nov. 9, 2022) ("I want to know explicitly whether you use [TPLF] or intend to use it in this case.").

whether a funder's approval for any litigation or settlement decisions is required).[24]

- Judge J. Philip Calabrese of the U.S. District Court for the Northern District of Ohio has a standing order similar to that of Judge Connolly, requiring the parties to disclose any TPLF funding agreements they may have.[25]

- Judge Paul W. Grimm of the U.S. District Court for the District of Maryland has also required lawyers leading an MDL proceeding concerning a data breach of Marriott hotels to make similar disclosures.[26]

Judge M. Casey Rodgers, who presided over the Combat Arms Earplug MDL proceeding and a recent $6.8 billion settlement, went even further than her fellow jurists. She not only required the parties using TPLF to disclose the agreements, but also "review[ed] those contracts with a high degree of scrutiny" after noting that "[f]or at least the past decade, settlements of th[e] size and nature [of the 3M settlement] have often attracted the attention of third-party litigation funding entities intending to prey on litigants, including settlement participants seeking litigation funding pending the receipt of potential settlement funds."[27] In addition, Judge Rodgers went beyond simply requiring disclosure of the agreements, specifically prohibiting any plaintiff from "obtain[ing] third-party litigation funding, absent the filing of a motion with, and obtaining the prior approval of, th[e] [c]ourt." [28]

Contrary to ILFA's suggestion, the Advisory Committee on Civil Rules also continues to consider a proposed amendment to Rule 26 that would require the production of TPLF agreements as a matter of course in all federal civil cases.[29] While the Advisory Committee has yet to move forward on the underlying proposal, it is included as an agenda item in the Advisory

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[24] *See* Standing Order Regarding Third-Party Litigation Funding Arrangements, https://www.ded.uscourts.gov/sites/ded/files/Standing%20Order%20Regarding%20Third-Party%20Litigation%20Funding.pdf. Notably, plaintiffs in multiple patent cases pending before Judge Connolly have challenged the standing order by filing a series of virtually identical petitions for a writ of mandamus with the U.S. Court of Appeals for the Federal Circuit. The Federal Circuit denied each of the petitions, signaling that the standing order will remain in effect for the foreseeable future. *See In re Nimitz Techs. LLC*, No. 2023-103, 2022 WL 17494845, at *3 (Fed. Cir. Dec. 8, 2022).

[25] *See* Rule 26(f) Report of the Parties, Standing Orders, Judge J. Philip Calabrese (N.D. Ohio), https://www.ohnd.uscourts.gov/sites/ohnd/files/Rule%2026%28f%29%20Report%20of%20the%20Parties%20%281.2.2024%29.pdf.

[26] *See* Case Mgmt. Order Regarding Model Leadership Appls. for Consumer Track at 2-3, *In re Marriott Int'l Customer Data Sec. Breach Litig.*, No. 8:19-md-02879-JPB, ECF No. 171 (D. Md. filed Apr. 11, 2019).

[27] Case Mgmt. Order No. 61 (Third-Party Litigation Funding) at 1, 3, *In re 3M Combat Arms Earplug Prods. Liab. Litig.*, No. 3:19-md-02885-MCR-HTC, ECF No. 3815 (N.D. Fla. filed Aug. 29, 2023).

[28] *Id.*

[29] Document No. 17-CV-O, https://www.uscourts.gov/sites/default/files/17-cv-o-suggestion_ilr_et_al_0.pdf (June 1, 2017), as supplemented by letter dated November 3, 2017, Document No. 17-CV-GGGGGG, https://www.uscourts.gov/sites/default/files/17-cv-gggggg-suggestion_us_chamber_et_al_0.pdf. The proposal has been further supplemented with updates and additional information regarding TPLF on an almost yearly basis. *See, e.g.*, Document No. 23-CV-M, https://www.uscourts.gov/sites/default/files/23-cv-m_suggestion_from_35_organizations_-_rule_26_0.pdf (May 8, 2023 letter); Document No. 22-CV-M, https://www.uscourts.gov/sites/default/files/22-cv-m_suggestion_from_lcj_and_ilr_-_rule_16c2_0.pdf (Sept. 8, 2022 letter).

Committee's October 10, 2024 Agenda Book and is still under consideration.[30] Indeed, as the Committee expressly noted in the portion of its 2019 report cited by ILFA, the Committee "continues to study third-party litigation funding (TPLF), ***including various proposals for disclosure***."[31]

ILFA's Letter does not address the substantial Congressional efforts currently underway to address the risks posed by undisclosed TPLF investments. Most recently, following a hearing on TPLF usage in U.S. courts,[32] Representative Darrell Issa (R-CA), Chairman of the House Judiciary Subcommittee on Courts, Intellectual Property, and the Internet, circulated a discussion draft of the Litigation Transparency Act of 2024.[33] The bill would apply to all civil cases in federal courts and would require: (1) disclosure of the use of TPLF within 10 days of execution of a TPLF agreement or when the lawsuit is filed, whichever is sooner; and (2) the production of TPLF agreements at the outset of any federal civil case. Another proposal currently pending before Congress is the Protecting Our Courts from Foreign Manipulation Act of 2023—a bipartisan bill introduced by Senators John Kennedy (R-LA) and Joe Manchin (R-WV) in the Senate, and by Speaker Mike Johnson (R-LA) in the House of Representatives.[34] The legislation would: (1) require disclosure of foreign sources of TPLF in American courts; (2) ban sovereign wealth funds ("SWFs") and foreign governments from investing in U.S. litigation; and (3) require the Department of Justice's national security division to submit a report on foreign TPLF

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[30] *See* Advisory Committee on Civil Rules October 10, 2024 Agenda Book, at 417 (October 2024) https://www.uscourts.gov/rules-policies/records-rules-committees/agenda-books ("It is included on the this agenda because there is an ongoing concern about the possible impact of litigation funding on civil litigation in the federal courts.").

[31] Hon. John D. Bates, Report of the Advisory Committee on Civil Rules, at 9 (June 4, 2019) (emphasis added) (cited in ILFA Letter at 3). More recent statements, including the October 10, 2024 Agenda Book from the Committee reflect its continued consideration of the proposal. *See, e.g.*, *supra* note 30; Report of the Advisory Committee on Civil Rules, at 9 (May 11, 2023) ("TPLF remains on the Committee's agenda . . . .") (cited in Committee on Rules of Practice & Procedure, at 792 (June 6, 2023)); Report of the Advisory Committee on Civil Rules, at 7 (Dec. 14, 2021) ("[B]ecause TPLF did appear to be an important and rapidly evolving matter, the Advisory Committee kept the topic on its agenda and has been monitoring it. . . . [T]he Advisory Committee did not decide that immediate action was called for, but it did recognize that TPLF is a large topic, and that continued monitoring was in order. This report outlines current thinking.") (cited in Committee on Rules of Practice & Procedure, at 190 (Jan. 4, 2022)).

[32] The U.S. Intellectual Property System and the Impact of Litigation Financed by Third-Party Investors and Foreign Entities: Hearing Before the Subcommittee on Courts, Intellectual Property, and the Internet, 118 Cong. (June 12, 2024).

[33] *See* Press Release, Representative Darrell Issa, *Issa Introduces Discussion Draft of Legislation Reforming Third-Party Financed Civil Litigation* (July 11, 2024), https://issa.house.gov/media/press-releases/issa-introduces-discussion-draft-legislation-reforming-third-party-financed.

[34] At the time of this letter, the bill's Senate sponsors were seeking to include its provisions as an amendment to the National Defense Authorization Act for 2025. *See* S.A. 2333 – 118th Congress (2023-2024): Protecting Our Courts From Foreign Manipulation, Amendment to S. 4638, 118th Cong. (July 11, 2024), https://www.congress.gov/118/crec/2024/07/11/170/115/CREC-2024-07-11-pt1-PgS4667-4.pdf.

to the federal judiciary.[35] The bills have been referred to the House and Senate Judiciary Committees and are awaiting further action.

ILFA similarly omits any discussion of the increasing attention to TPLF by the Executive Branch, which has also recognized the importance of TPLF disclosure. For example, the Securities and Exchange Commission adopted a rule requiring private equity firms to disclose the percentage of their capital targeted for litigation funding.[36] In addition, a growing number of states have recently enacted laws requiring the disclosure of TPLF arrangements. For example:

- In 2018, Wisconsin became the first state to require that "a party shall, without awaiting a discovery request, provide to the other parties any agreement under which any person . . . has a right to receive compensation that is contingent on and sourced from any proceeds of the civil action, by settlement, judgment, or otherwise."[37]

- West Virginia enacted a TPLF disclosure law in 2019, which, like Wisconsin's law, requires disclosure of agreements where a litigation financier has a right to receive compensation from the lawsuit.[38] In March 2024, West Virginia's governor signed into law amendments that, among other things: (1) updated the definition of "consumer" to include non-natural people (i.e., businesses); (2) removed commercial tort claims from the list of items excluded from the definition of TPLF; and (3) clarified that counsel are subject to the disclosure requirement.[39]

- Montana recently enacted a bill requiring the disclosure of TPLF agreements that are used to finance lawsuits brought by consumers.[40] This legislation was passed with a unanimous vote in both chambers of the state legislature. The new law also requires that litigation funders register with the Montana secretary of state, makes funders jointly liable for costs, and establishes a 25% cap on the amount that a funder may receive or recover from a lawsuit.

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[35] Press Release, U.S. Senator John Kennedy, *Kennedy, Manchin Introduce Bipartisan Protecting Our Courts from Foreign Manipulation Act to End Overseas Meddling in U.S. Litigation* (Sept. 14, 2023), https://www.kennedy.senate.gov/public/2023/9/kennedy-manchin-introduce-bipartisan-protecting-our-courts-from-foreign-manipulation-act-to-end-overseas-meddling-in-u-s-litigation; *see also* Press Release, U.S. Congressman Mike Johnson, *Johnson Introduces Bipartisan 'Protecting Our Courts from Foreign Manipulation Act' to End Overseas Meddling in U.S. Litigation* (Sept. 14, 2023), https://mikejohnson.house.gov/news/documentsingle.aspx?DocumentID=1339.

[36] *See* Andrew Ramonas, *SEC Tells Private Equity Firms to Report on Litigation Finance*, Bloomberg Law (May 3, 2023), https://news.bloomberglaw.com/esg/sec-tells-private-equity-firms-to-report-on-litigation-finance.

[37] 2017 Wis. Act 235, https://docs.legis.wisconsin.gov/2017/related/acts/235.

[38] W. Va. Code Ann. § 46A-6N-6 (enacted 2019).

[39] S.B. 850, 2024 Reg. Sess. (W.V. Mar. 9, 2024) (signed Mar. 27, 2024).

[40] *See* MT LEGIS 360 (2023), 2023 Montana Laws Ch. 360 (S.B. 269) (enacted 2023).

- Indiana also recently passed a law similarly requiring the disclosure of TPLF agreements with consumer parties.[41] Indiana amended that law to also ban funding by certain foreign parties, prohibit commercial litigation financiers from making litigation and settlement decisions, bar parties from providing sealed or protected documents to their litigation funders, and make the contents of commercial litigation funding agreements discoverable.[42]

- Most recently, on June 19, 2024, Louisiana Governor Jeff Landry signed into law Senate Bill 355.[43] The newly enacted law requires, among other things: (1) foreign funders to disclose certain information to Louisiana's attorney general; (2) prohibits funders from influencing or making certain litigation and settlement decisions; and (3) makes the existence of TPLF agreements subject to discovery under Louisiana's Code of Civil Procedure and Code of Evidence rules.[44]

ILFA does not address any of these developments in its Letter. Instead, it baldly claims that the lack of similar legislation in Texas "is a clear signal to the Supreme Court Advisory Committee that the regulation or disclosure of litigation finance is not supported by the members of the legislative body of Texas."[45] But that is rank speculation. Indeed, the fact that other states are increasingly enacting laws designed to make TPLF more transparent strongly suggests that legislators in Texas will likewise be open to reforming this highly secretive practice. In any event, the Supreme Court has a fundamental obligation to ensure the ethical functioning of the Texas civil justice system—irrespective of the views of individual lawmakers with regard to TPLF. Given the serious ethical and other issues raised by TPLF (e.g., improper control over litigation and settlement decisions), a disclosure rule would further that important function.[46]

In short, ILFA is understating the growing recognition among courts, lawmakers, and policymakers that TPLF lacks sufficient transparency.

Second, the variability of existing TPLF rules highlights why the Texas judicial system would benefit from a uniform approach to this issue. While the undersigned are unaware of—and have not been able to find—examples of Texas judges addressing TPLF, it is inconceivable

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[41] IN LEGIS 63-2023 (2023), 2023 Ind. Legis. Serv. P.L. 63-2023 (H.E.A. 1124) (enacted 2023).

[42] Ind. Code Ann. § 24-12-1-0.5, et. seq.

[43] Mark Popolizio, *Louisiana Enacts New Third-Party Litigation Funding (TPLF) Law*, Verisk (June 27, 2024), https://www.verisk.com/blog/louisiana-enacts-new-third-party-litigation-funding-tplf-law/.

[44] *See generally* https://legis.la.gov/legis/ViewDocument.aspx?d=1382655.

[45] ILFA Letter at 7-8.

[46] ILFA also claims that Texas courts have a long history of permitting champerty and maintenance because "there is little caselaw in existence" regarding those doctrines in this State. ILFA Letter at 5. But the lack of such caselaw does not mean that the doctrine has been completely abrogated. If anything, the limited caselaw suggests that champerty "may have been replaced or superseded by Texas's barratry statute," which prohibits "the solicitation of employment to prosecute or defend a claim with intent to obtain a personal benefit." *Campbell v. Chase Home Fin. LLC*, No. A-10-CA-884-SS, 2011 WL 13324033, at *2 (W.D. Tex. Sept. 27, 2011) (quoting *State Bar of Tex. v. Kilpatrick*, 874 S.W.2d 656, 658 n.2 (Tex. 1994)). ILFA does not offer any reason why the public policy underlying Texas's barratry statute would not be fairly served by shining some light on secretive investments in litigation that are being made for the sole purpose of pecuniary gain.

that the practice is not being used in this State. As a result, if Texas courts are not already grappling with questions related to TPLF, they will soon have no choice but to confront them. And absent a statewide rule governing TPLF transparency, there is a substantial risk that judges in Texas will take widely divergent approaches.

The federal examples highlighted in ILFA's letter illustrate the checkerboard of differing approaches. For example, at one end of the spectrum is a rule in effect in the District of New Jersey that requires each party to file a certification within 30 days of docketing of the case that discloses the identity of each funder (name, address, place of formation), states whether the funder's approval is necessary for litigation and settlement decisions, and provides a description of the nature of the financial interest.[47] Parties may also be entitled to additional discovery on the details of TPLF agreements upon a showing of good cause.[48] By contrast, a standing order in the Northern District of California only requires parties to provide limited identifying information, has no provisions for additional discovery of the terms of any agreements, and, most importantly, only applies to class, collective, and representative actions.[49]

ILFA also claims that "[v]ery limited disclosure rules have been adopted in" the federal opioid and Zantac MDL proceedings.[50] But while the rules in place in those two litigations are a step in the right direction, they are inadequate. As ILFA acknowledges, the approach taken in those proceedings was for the judge to rely on plaintiffs' counsel's say-so *in camera*—i.e., outside the presence of the defendants. In particular, the counsel whose clients were using TPLF were required to attest that the underlying agreements did not give the funders "any control over litigation strategy or settlement decisions."[51] However, a "yes/no" answer to such a question says nothing about the nature of the arrangement, much less whether it vests an outside funder with authority to influence or control the litigation. Nor can it possibly suffice for a judge to uncritically accept one party's representation that the agreement it or its client has entered into does not raise any control or influence issues. Based on the allegations in the *Sysco* case previously discussed, a lawyer may feel justified in saying that a contract providing the investor shall not "unreasonably withhold" consent does not cede control. But to truly grasp whether an investor retains control, it is necessary to fully and critically examine the agreement itself—with input from all parties—because there may be boilerplate language purporting to preserve party and counsel control that is inconsistent with other substantive provisions empowering funders.

Reviewing an agreement *ex parte* provides judges with better information, but it puts judges in the precarious and complicated position of interpreting contracts without the benefit of the analysis of the other parties to the case and while withholding information from them. A requirement that litigants produce funding agreements to the other side would prevent such a thorny scenario from ever arising by subjecting funding agreements to the adversarial process

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[47] *See* D.N.J. L. Civ. R. 7.1.1(a).

[48] *See id.*

[49] Standing Order for All Judges of the Northern District of California (Nov. 1, 2018).

[50] ILFA Letter at 4-5.

[51] *Id.* (opioid litigation); *see also id.* (counsel in the *Zantac* litigation were required to answer whether "the litigation funder ha[s] any control . . . over the decision to file or the content of any motions or briefs, or any input into the decision to accept a settlement offer?").

and affording party opponents the opportunity to challenge generic claims that investors are not controlling or influencing the case.

Notably, in contrast to the varying federal approaches to TPLF disclosure, the states that have most recently weighed in on the issue (e.g., Wisconsin, West Virginia, Montana, and Indiana) have generally embraced the approach the undersigned are advocating here. Each of those states generally requires disclosure of the existence of TPLF and the production of the TPLF funding agreement to both the court and the opposing party. Adopting a similar approach in Texas would ensure both that judges in this State approach TPLF disclosure uniformly and that all litigants and courts are consistently able to ascertain whether the usage of TPLF in a given case raises any legal or ethical issues.

As the examples highlighted by ILFA and the undersigned illustrate, there is no question that judges and policymakers are growing increasingly concerned with the secrecy surrounding TPLF. While the federal approaches are an important step in the right direction, their divergent nature underscore why a single statewide approach is the most sensible way to address the issue within the Texas judicial system. And an amendment to the Texas Rules of Civil Procedure requiring any party using TPLF to produce the underlying agreement to his or her opponent at the outset of the case would do just that.

IV. THE RISE OF TPLF RAISES NEW QUESTIONS ABOUT POTENTIAL MANIPULATION OF THE U.S. JUDICIAL SYSTEM BY FOREIGN ACTORS.

ILFA contends that there is “zero evidence that a hostile foreign state has invested in litigation financing in this country.”[52] This argument is unpersuasive for several reasons. For starters, it is entirely circular. As previously discussed, virtually all TPLF activity in U.S. courts occurs in secrecy because there is presently no generally applicable statute or rule requiring disclosure.[53] Moreover, to the extent that defendants seek this information through ordinary discovery, plaintiffs generally resist strenuously, and courts often do not compel production of the requested information. Thus, the existence of TPLF in a particular civil action typically becomes known to the court and the parties ***only if*** there is compliance with a local rule or standing order requiring disclosure (or a public dispute emerges between the plaintiff and the funder). Accordingly, the lack of direct evidence of a foreign hostile actor investing in litigation is of little import.

In any event, the limited data that we do have show that foreign actors, including SWFs and state-owned and operated investment funds, are becoming increasingly involved in TPLF. Indeed, it has come to light that certain Russian billionaires with ties to Vladimir Putin have financed lawsuits around the world through their investment firms in an effort to evade international sanctions. Specifically, Bloomberg has published an investigation of a company called A1 that is a subsidiary of a Russian investment company called Alfa Group. A1 has spent about $20 million in ongoing bankruptcy cases in New York and London on behalf of a Russian agency seeking to recover assets that were embezzled from a Moscow bank. In fact, after three

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[52] *Id.* at 10.

[53] *See* Anderson, *supra* note 1.

A1 directors were sanctioned in the UK, the three sanctioned directors sold A1 for about $900 to another A1 director who had not been sanctioned. The director who purchased A1, Alexander Fain, admitted in a bankruptcy proceeding that he purchased A1 because of a "'complicated geopolitical situation' potentially affecting the litigation."[54]

The Bloomberg investigation led to questions in Congress, and Deputy Treasury Secretary Wally Adeyemo testified at a Senate hearing that the Treasury Department needs to investigate the use of litigation finance in the U.S. by foreign actors. Adeyemo testified that litigation financing by foreign actors "is an issue we have to look, we have to both work on and try and address."[55] The Deputy Secretary went on to note that "[o]ne of the challenges we have, of course, is that these Russian oligarchs have become quite expert at trying to avoid our sanctions . . . [a]nd from what I've seen, [TPLF] is one of the several ways they're trying to do that."[56]

Foreign investment in U.S. litigation also raises concerns over the misuse of confidential information by foreign actors, including potential adversaries. Purplevine IP Operating Co., Ltd. (Purplevine), a China-based firm that markets itself as a one-stop IP service provider, is financing at least four intellectual property lawsuits in U.S. courts against Samsung Electronics Co. and a related subsidiary.[57] Unlike in most cases, Purplevine's role within the litigation was involuntarily disclosed during litigation in Delaware due to a standing order that the judge overseeing the case—Chief U.S. District Judge Colm Connolly—had previously entered requiring certain basic TPLF-related disclosures.[58] This disclosure, subsequent reporting, and facts learned at trial revealed a tangled relationship between this litigation funder and the patent claims at issue and suggest that Purplevine may have received and relied upon privileged, confidential and highly sensitive information in bankrolling Staton Techiya, LLC's (Techiya) patent infringement claims against Samsung.[59] Although the patent technology at issue related to sound systems and did not directly implicate national security concerns per se,[60] the alleged

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[54] Emily R. Siegel & John Holland, *Putin's Billionaires Dodge Sanctions by Financing Lawsuits*, Bloomberg Law (Mar. 28, 2024), https://news.bloomberglaw.com/litigation-finance/putins-billionaires-sidestep-sanctions-by-financing-lawsuits.

[55] Emily R. Siegel, *Russian Use of Litigation Finance Needs Scrutiny, Treasury Says*, Bloomberg Law (Apr. 10, 2024), https://news.bloomberglaw.com/business-and-practice/russian-use-of-litigation-finance-needs-scrutiny-treasury-says.

[56] *Id.*

[57] Emily R. Siegel, *China Firm Funds US Suits Amid Push to Disclose Foreign Ties*, Bloomberg Law (Nov. 6, 2023), https://news.bloomberglaw.com/business-and-practice/china-firm-funds-us-lawsuits-amid-push-to-disclose-foreign-ties; https://www.purplevineip.com/en/.

[58] *See* Pl.'s Statement Regarding Third-Party Litigation Funding Arrangements, *Staton Techiya, LLC v. Harman Int'l Indus., Inc.*, No. 1:23-cv-00801-JCG, ECF No. 7 (D. Del. filed Aug. 24, 2023).

[59] *See* Samsung's Mot. for Leave to Amend Answer & Counterclaims to Join Purplevine & PV Law as Counterclaim Defs. at 5-6, 14-15, *Staton Techiya, LLC v. Samsung Elecs. Co.*, No. 2:23-cv-00319-JRG-RSP, ECF No. 65 (E.D. Tex. filed June 13, 2023).

[60] *See generally* Compl., *Staton Techiya, LLC v. Harman Int'l Indus., Inc.*, No. 1:23-cv-00801-JCG, ECF No. 1 (D. Del. filed July 25, 2023). An apparent relationship between Purplevine and Chinese consumer electronics giant TCL Corp. raises further questions about whether it or any other foreign actors are investing in U.S. litigation

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misappropriation of discovery and other confidential litigation materials in the case illustrates the kind of misconduct that could unfold when a foreign entity chooses to fund litigation involving sensitive technology (e.g., semiconductors) that is critical to U.S. national security.[61]

These concerns are not new. More than a decade ago, a leading academic expert on TPLF warned that "the China Investment Corporation (CIC), China's Sovereign Wealth Fund, [could] fund[] a suit against an American company in a sensitive industry such as military technology" and, in the process, "obtain[] highly confidential documents containing proprietary information regarding sensitive technologies from the American defendant-corporation."[62] Multiple federal and state lawmakers have recently echoed this concern. Most recently, in a July 11, 2024 letter to the Committee on Rules of Practice and Procedure of the Administrative Office of the United States Courts, Texas's own Senator John Cornyn (R-TX) and Senator Thom Tillis (R-NC) warned that "[l]itigation funding is an available weapon for foreign investors to attack domestic businesses" and that "[f]oreign adversaries could use litigation funding mechanisms to weaken critical industries or obtain confidential materials."[63] Also in July 2024, Chairman James Comer (R-KY) of the House Committee on Oversight and Accountability, wrote to Chief Justice John Roberts, urging the Judicial Conference to enact rules requiring TPLF disclosure, noting that TPLF "is now being abused by domestic and foreign actors."[64] Similarly, Senator John Kennedy (R.-LA), in a letter to Chief Justice John Roberts and U.S. Attorney General Merrick Garland, warned that "[m]erely by financing litigation in the United States against influential individuals, corporations, or highly sensitive sectors, a foreign actor can advance its strategic interests in the shadows since few disclosure requirements exist in jurisdictions across our country."[65] In letters to the chief judges of Florida's federal district courts in November 2023, Senators Marco Rubio (R-FL) and Rick Scott (R-FL) "highlight[ed] the dangers of foreign third-party litigation funding (TPLF) and the need for more transparency in the federal judiciary

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for questionable purposes—i.e., to undermine competitors, including in sensitive industries. *See* Emily R. Siegel, *China Firm Funds US Suits Amid Push to Disclose Foreign Ties*, Bloomberg Law (Nov. 6, 2023), https://news.bloomberglaw.com/business-and-practice/china-firm-funds-us-lawsuits-amid-push-to-disclose-foreign-ties.

[61] Notably, 14 state attorneys general sent a letter to the U.S. Department of Justice, bemoaning the secrecy surrounding TPLF and questioning what U.S. Attorney General Merrick Garland and other top officials are doing to ensure that the practice is not threatening U.S. national security interests. *See generally* Letter from Christopher M. Carr (GA), Jason Miyares (VA) et al. to DOJ re: Threats Posed by Third-Party Litigation Funding (Dec. 22, 2022), https://www.tn.gov/content/dam/tn/attorneygeneral/documents/pr/2022/pr22-55-letter.pdf ("Carr 12/22/22 Letter").

[62] Maya Steinitz, *Whose Claim is This Anyway? Third-Party Litigation Funding*, 95 Minn. L. Rev. 1268, 1270 (2011).

[63] Letter from U.S. Senators John Cornyn & Thom Tillis to H. Thomas Byron III (July 11, 2024), https://www.cornyn.senate.gov/wp-content/uploads/2024/07/7.11.24-TPLF-Letter.pdf.

[64] Letter from U.S. Congressman James Comer to Hon. John Roberts (July 12, 2024), https://oversight.house.gov/wp-content/uploads/2024/07/TPLF-Letter-07122499.pdf.

[65] Press Release, U.S. Senator John Kennedy, *Kennedy Urges Roberts, Garland to Take Action to Protect National Security from Foreign Actors Meddling in U.S. Courts* (Jan. 9, 2022), https://www.kennedy.senate.gov/public/press-releases?ID=1FBC312C-94B8-409B-B0A3-859A9F35B9F5.

as it relates to this matter."[66] And in a letter to the Department of Justice ("DOJ"), 14 state attorneys general similarly raised questions surrounding the secrecy of foreign TPLF and urged the federal government to take concrete actions to ensure that the practice is not undermining U.S. national security interests.[67]

Most recently, the chief of the Foreign Agents Registration Act ("FARA") Unit at the DOJ, Evan Turgeon, highlighted concerns regarding foreign investment in U.S. litigation. Chief Turgeon explained that the Unit is focusing on SWFs that serve as the alter egos of foreign governments and thus engage in activities that directly promote foreign governments' interests.[68] He also expressed concern regarding the implication of foreign entities funding litigation in U.S. courts. According to Chief Turgeon, foreign entities can weaponize litigation to tie up U.S. businesses and deplete their resources, providing foreign competitors with an advantage. He further expressed concern that foreign adversaries may fund litigation on divisive issues to try to inflame tensions and sow division among the U.S. public. In addition, he cautioned that many foreign litigation funding entities are likely engaged in registrable conduct not covered by the legal or commercial exemptions.

Finally, the bipartisan House Select Committee on the Strategic Competition Between the United States and the Chinese Communist Party has released a report outlining a general strategy to reset the economic relationship between the U.S. and China. In that report, the Committee included two recommendations related to TPLF: (1) that the U.S. "[d]etermine, and then establish, what guardrails are needed to address the possibility of foreign adversary entities obtaining sensitive IP through funding third-party litigation in the United States"; and (2) "[f]or litigation in federal court, require enhanced disclosures for foreign adversary entities and provide judges with the authority to require enhanced disclosures for certain entities under foreign adversary entity control regarding their funding, and, when appropriate, ownership and connection with the foreign adversary government and dominant political party."[69]

In light of these repeated (and growing) concerns and recent examples highlighting the potential for evasion of U.S. sanctions laws and potential misappropriation of confidential and potentially sensitive technology, foreign entities underwriting U.S. litigation undoubtedly raises serious national and economic security questions. The only logical way to resolve those questions is by requiring the disclosure of TPLF arrangements—a simple exercise that will help judges understand if foreign nationals or state actors are using the Texas civil justice system as an unwitting forum for achieving strategic (and perhaps nefarious) goals.

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[66] Press Release, U.S. Senator Marco Rubio, *Rubio, Scott Push for Transparency for Foreign Third Party Litigation Funding in U.S. Courts* (Nov. 3, 2023), https://www.rubio.senate.gov/rubio-scott-push-for-transparency-for-foreign-third-party-litigation-funding-in-u-s-courts/.

[67] *See* Carr 12/22/22 Letter, *supra* note 60.

[68] *See* Brandon L. Van Grack et al., *FARA Officials Preview Major Regulatory Changes and Identify New Areas of Focus*, Lexology (Dec. 6, 2023), https://www.lexology.com/library/detail.aspx?g=06449b32-a4ab-45d1-b623-6c9f157db21c.

[69] U.S. Congress, *Reset, Prevent, Build: A Strategy to Win America's Economic Competition with the Chinese Communist Party*, at 21, https://selectcommitteeontheccp.house.gov/sites/evo-subsites/selectcommitteeontheccp.house.gov/files/evo-media-document/reset-prevent-build-scc-report.pdf.

V. ILFA'S CONCERN THAT FUNDING AGREEMENTS CONSTITUTE PROTECTED ATTORNEY WORK PRODUCT IS OVERSTATED.

ILFA also argues TPLF agreements are protected from disclosure under the work-product doctrine.[70] ILFA cites two cases in support of this argument—*Hardin v. Samsung Elecs. Co.*, No. 2:21-CV-00290-JRG, 2022 WL 14976096, at *2-3 (E.D. Tex. Oct. 25, 2022), and *United States ex rel. Fisher v. Ocwen Loan Servicing, LLC*, No. 4:12-CV-543, 2016 U.S. Dist. LEXIS 32967, at *16 (E.D. Tex. Mar. 15, 2016). But those cases involved sweeping discovery requests that included not only the underlying funding agreement itself, but also a litany of other materials and attorney-client communications revealing actual litigation strategy that were undeniably work product and are well outside the scope of the undersigned's proposal.

The reality is that few courts have actually addressed the precise question of whether funding agreements themselves merit work-product protection. The starting point for any work-product analysis is Texas Rule of Civil Procedure 192.5, which provides that "material prepared," "mental impressions developed," or "communication[s] made" "***in anticipation of litigation or for trial***" are generally not subject to discovery.[71] Of course, the mere existence of TPLF in a case, the name of the funder, and other basic facts related to TPLF are not "material prepared," "mental impressions," or "communications" and thus fall far outside the scope of the doctrine. And wholescale application of the doctrine to the funding agreements themselves is far from clear. A number of courts outside the TPLF context have taken a narrow approach to work-product protection, choosing to apply the doctrine only in situations where the "primary purpose" behind creating the materials was for litigation, ***not*** to further one's business.[72] Because TPLF agreements are created primarily for the purpose of funding litigation, courts that have adopted the "primary purpose" test for analyzing work-product questions should reject claims that the funding agreements are work-product. This is all the more true for portfolio-based TPLF agreements in which an investor chooses to bankroll a group of cases—a decision that is not tied to a particular lawsuit and cannot fairly be said to reflect any legal strategy.

While a handful of courts that have assessed whether funding agreements constitute work product have concluded that the contracts are encompassed by the doctrine, even those courts have been forced to concede that the purpose of a TPLF agreement is quintessentially ***business*** in nature "because the litigation itself arguably is part of the business."[73] Those courts have nonetheless opted to extend work-product protection to the funding agreement on the ground that it was created "because of" litigation, even though business—as opposed to litigation—might have been the primary purpose of the contract.[74] Opting in favor of the narrower "primary purpose" test would more closely align with the overall purpose behind the work-product

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[70] ILFA Letter at 8-9.

[71] Tex. R. Civ. P. 192.5 (emphasis added).

[72] *See In re Blue Cross Blue Shield Antitrust Litig.*, No. 2:13-CV-20000-RDP, 2015 WL 10891632, at *6 (N.D. Ala. Nov. 4, 2015).

[73] *Carlyle Inv. Mgmt. L.L.C. v. Moonmouth Co. S.A.*, No. 7841-VCP, 2015 WL 778846, at *8 (Del. Ch. Feb. 24, 2015).

[74] *Id.*

doctrine, by "focus[sing] on the original reasons and purpose for the creation of a document rather than the post hoc characterization of the document ***after*** litigation commences."[75]

In any event, even assuming that funding agreements are technically prepared "in anticipation of litigation," work-product protection is not an ironclad shield. Rather, the protection afforded by the doctrine must yield to disclosure where the requesting party has demonstrated a "substantial need" for the information that cannot be obtained from another source, as a number of courts have recognized. A federal magistrate judge implicitly recognized as much in a decision denying a motion to compel the production of a funding agreement in a patent dispute, noting in a footnote that "[d]efendants do not argue, nor have they shown, that there is a substantial need for these materials and that they will suffer undue hardship in their absence."[76]

For example, in one case, production of a funding agreement was ordered where the funder was alleged to be the real party in interest in the underlying litigation. *In re International Oil Trading Co.*, arose out of litigation between Mohammad Al-Saleh and the International Oil Trading Company, LLC ("IOTC USA") related to the procurement of fuel.[77] When the parties' relationship soured, Al-Saleh entered into a contract with Burford to fund his litigation against IOTC USA, which resulted in a judgment against IOTC USA. After Al-Saleh was unable to collect on the judgment, he filed an involuntary bankruptcy petition. IOTC USA responded to the petition by arguing that Al-Saleh was not the real party in interest; in essence, ***Burford*** (not Al-Saleh) was "in the driver's seat." IOTC USA proceeded to request various materials related to the funding, including the funding agreement itself. The bankruptcy court refused to require the production of actual ***communications*** between Mr. Al-Saleh and Burford. But it found that the funding contract itself was fair game subject to some minor redactions of terms reflecting opinions regarding the merits of the litigation.

Courts have also ordered production of funding agreements where a party has claimed some kind of impropriety (e.g., bias, fraud, or lack of control) in connection with the third-party funding. For example, a court presiding over the bankruptcy of Gawker Media LLC ordered production of funding agreements to explore Gawker's theory that a variety of pre-bankruptcy lawsuits funded by Peter Thiel were part of a "coordinated campaign against" Gawker.[78] Production was also ordered in pelvic mesh litigation where the court determined that documents related to the financing of corrective surgeries and other materials were highly relevant to understanding "the motivation behind the plaintiffs' decisions to undergo corrective surgeries," and would allow the defendant to "gauge the credibility and motives of the nonparties or their agents when interacting with the plaintiffs."[79]

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[75] *In re Blue Cross Blue Shield*, 2015 WL 10891632, at *6 (emphasis added).

[76] *Lambeth Magnetic Structures, LLC v. Seagate Tech. (US) Holdings, Inc.*, Nos. 16-538 & 16-541, 2017 U.S. Dist. LEXIS 215773, at *17 n.8 (W.D. Pa. Dec. 19, 2017).

[77] *In re Int'l Oil Trading Co.*, 548 B.R. 825 (Bankr. S.D. Fla. 2016).

[78] *In re Gawker Media LLC*, No. 16-11700 (SMB), 2017 WL 2804870, at *2 (Bankr. S.D.N.Y. June 28, 2017) (citation omitted).

[79] *In re Am. Med. Sys., Inc.*, MDL No. 2325, 2016 WL 3077904, at *5 (S.D. W. Va. May 31, 2016).

Another circumstance in which courts have ordered production of funding agreements involves purported class actions, where courts have recognized that the terms of these agreements bear directly on whether a named plaintiff and his or her counsel will adequately represent the absent class members. Judge Susan Illston emphasized this concern in *Gbarabe v. Chevron Corp.*, a putative class action arising out of an explosion on an oil drilling rig off the coast of Nigeria.[80] Judge Illston found that the "funding agreement [was] relevant to the adequacy [of representation] determination [required for class certification] and should be produced to [the] defendant."[81]

In summary, while certain communications regarding TPLF may constitute attorney work product in certain circumstances, actual funding agreements are not entitled to such protection. And even assuming such agreements qualify as attorney work-product, a defendant's substantial need for it (e.g., in class actions) would justify disclosing it. Simply put, there is little support for the notion that TPLF agreements themselves should be wholesale shielded from discovery by the work-product doctrine.

VI. DISCLOSURE OF TPLF AGREEMENTS WILL NOT CHILL FREE SPEECH.

Finally, there is no truth to ILFA's claim that a disclosure requirement will somehow "chill" free speech or infringe on First Amendment protections.[82] That claim is based on a false premise—i.e., that a disclosure rule would require that non-profit organizations involved with public advocacy litigation to disclose their "financial resources" (e.g., donors).[83] Nothing could be further from the truth. The proposal supported by the undersigned would be strictly limited to commercial, for-profit enterprises that actually invest in litigation—i.e., buy an interest in the outcome of a lawsuit seeking money damages. By focusing on those who have invested in litigation for profit-making purposes, the proposal is tailored to cover circumstances in which third parties will derive a direct financial benefit from the outcome of the action. To suggest that this requirement will somehow disrupt non-profit organizations from pursuing such litigation or chill the willingness of their donors to contribute is far-fetched to say the least.

Moreover, to the extent there is any ambiguity over this question, the undersigned would be amenable to tweaking the language of the underlying proposal to explicitly exempt non-profit organizations from the reach of the disclosure rule, as well as their donors. Simply put, organizations that are engaged in public interest advocacy are not for-profit enterprises, much less companies engaged in the business of third-party litigation funding. Rather, they are non-profit entities that initiate litigation to effect change through injunctive or declaratory actions. Any attempt to compare these organizations to the Burfords of the world is an attempt to muddy the waters and obstruct making actual investments in litigation more transparent.

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[80] *Gbarabe v. Chevron Corp.*, No. 14-cv-00173-SI, 2016 U.S. Dist. LEXIS 103594, at *5-6 (N.D. Cal. Aug. 5, 2016).

[81] *Id.*

[82] ILFA Letter at 6-7.

[83] *Id.*

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At bottom, ILFA's Letter downplays the concerns posed by secret third-party investments in civil litigation, while overstating the consequences of making that clandestine practice just a little more transparent. The Supreme Court should not fall for this sleight of hand. Rather, it should follow the lead of several other states that have recently required the disclosure of TPLF arrangements.

Sincerely,

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General Counsel
Texas Civil Justice League

Stephen Waguespack
President
U.S. Chamber of Commerce Institute for Legal Reform

Molly Craig
President
Lawyers for Civil Justice

October 2, 2024

H. Thomas Byron III, Secretary
Committee on Rules of Practice and Procedure
Administrative Office of the United States Courts
One Columbus Circle, NE, Room 7-300
Washington, D.C. 20544

Re: Procedural Consistency for the Disclosure of Third-Party Litigation Funding

Dear Mr. Byron:

Our companies, actively engaged in the federal civil justice system as both plaintiffs and defendants, are concerned about the procedural inconsistencies and deficiencies related to disclosure of third-party litigation funding ("TPLF"). As federal judges have become increasingly aware of the reasons why courts and parties need to know about TPLF, they are employing varied and often insufficient means of inquiry. We respectfully ask the Advisory Committee on Civil Rules ("Advisory Committee") to amend the Federal Rules of Civil Procedure ("FRCP") to provide a uniform and efficient procedure for disclosure of TPLF agreements in civil cases.

I. IT IS UNFAIR TO DENY PARTIES INFORMATION ABOUT WHO CONTROLS THE LITIGATION

We need TPLF disclosure to understand who has control of the case. We know from experience that when TPLF is present in our cases, it fundamentally alters the dynamics and has a major impact on whether the dispute can be resolved through settlement. We cannot make informed decisions without knowing the stakeholders who control the litigation—and we cannot understand the control features of a TPLF agreement without reading the agreement. Without this information, the settlement process often unravels when the nominal plaintiff or its counsel needs to obtain approval from undisclosed non-party funders or uses the non-party as an excuse to retract a commitment to settle. (This is the very reason why courts typically require us to appear with authority and our insurance representatives in settlement conferences and mediations.)

II. DISCLOSURE OF TPLF AGREEMENTS IS ESSENTIAL TO THE FUNCTION OF KEY FRCP AND WITNESS SAFEGUARDS

When defendants are kept in the dark about TPLF agreements, they are prevented from utilizing several key FRCP provisions as intended. For example:

- FRCP 26(b)(1) describes "the resources of the parties" as a factor relevant to whether a particular discovery request is proportional to the needs of the case. When courts do not allow us to know if the named parties are funded by TPLF investors, we cannot argue, and the court cannot weigh, how the resources of the parties should factor into decisions about the scope of discovery. This proportionality factor, which was added to the FRCP in 2015, is meaningless when TPLF agreements providing resources to a party are kept secret.

- Similarly, if we are not allowed to understand the control features and resource provisions of TPLF agreements, we are significantly constrained in making meaningful arguments about allocating costs pursuant to FRCP 26(c)(1)(B) and sanctions under FRCP 37.
- Without TPLF disclosure, we have no ability to expose to the court and jury when witnesses have conflicts of interest caused by their financial relationship with non-party funders, including direct payments as well as the potential that they will financially benefit from the outcome of the case.
- When we do not know who stands to benefit directly from the judgment or settlement in a case, we do not have the protection of FRCP 17(a)(1), which requires that "[a]n action must be prosecuted in the name of the real party in interest."

III. INADEQUATE PRACTICES SUCH AS *EX PARTE* CONVERSATIONS SHOULD NOT BE THE STANDARD MEANS OF INQUIRY ABOUT TPLF

Some judges ask whether parties are using TPLF during initial scheduling conferences. Other judges engage in *ex parte* discussions with plaintiffs' counsel in chambers, sometimes reviewing portions of a TPLF agreement *in camera*. Still others have issued written orders requiring counsel to answer questions in writing, *ex parte*, about TPLF agreements but not reviewing the underlying TPLF agreements. Problematically, few judges follow up during the course of litigation to ask whether new TPLF deals have been struck since their initial questions or give any indication that disclosure is an ongoing obligation. And, of course, some judges continue to resist making any sort of inquiry whatsoever. This variety of approaches and inconsistent practices is creating a fragmented and incoherent procedural landscape in the federal courts.

The FRCP should establish a uniform and straightforward procedure for initial TPLF disclosure and continuing notification of changes so courts do not have to devise their own schemes and parties do not have to guess what will be required or allowed from court to court and case to case. A rule is particularly needed to supersede the misplaced reliance on *ex parte* conversations; *ex parte* communications are strongly disfavored by the Code of Conduct for U.S. Judges (Canon 3(A)(4)) because they are both ineffective in educating courts and highly unfair to the parties who are excluded. FRCP guidance is necessary to supplant practices by which courts are entertaining potential factual and legal disagreements – and in effect ruling on them – without the benefit of the other parties' views and without informing the parties that the court is reaching conclusions on legal questions.

IV. DEFENDANTS NEED TPLF DISCLOSURE FOR THE SAME REASONS THE FRCP PROVIDE PLAINTIFFS WITH OUR INSURANCE AGREEMENTS

Our companies need to know about TPLF when we are sued for the same reasons that the Advisory Committee promulgated FRCP 26(a)(1)(A)(iv) to require defendants to disclose our insurance agreements. The Advisory Committee explained in 1970 that disclosure of insurance contracts "will enable counsel for both sides to make the same realistic appraisal of the case, so that settlement and litigation strategy are based on knowledge and not speculation." The Advisory Committee's reasoning applies equally to TPLF agreements because we need to be aware of key factors to make realistic and knowing assessments of the case and to develop appropriate litigation strategies. Without this information, we are at a major disadvantage in determining whether there are non-parties with a direct interest in, and influence or control over, the outcome of the case and in understanding whether the case can be resolved through settlement.

CONCLUSION

We urge the Advisory Committee to propose a straightforward, uniform rule for TPLF disclosure to remedy the current imbalanced and inconsistent litigation dynamic that is prejudicial and frustrates civil justice. The FRCP should require disclosure of TPLF agreements that provide non-parties a direct interest in the outcome of the case. Absent such a rule, the continued uncertainty and court-endorsed secrecy of non-party funding in our cases will further unfairly skew federal civil litigation.

Thank you for your consideration.

Sincerely,

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LCJ
LAWYERS FOR CIVIL JUSTICE

U.S. Chamber of Commerce
Institute for Legal Reform

RULES SUGGESTION
to the
ADVISORY COMMITTEE ON CIVIL RULES

IT IS TIME TO ADDRESS THE PATCHWORK OF INADEQUATE PRACTICES: HOW THE LACK OF FRCP GUIDANCE IS FAILING COURTS AND PARTIES WHO NEED A UNIFORM AND CREDIBLE PROCEDURE FOR UNDERSTANDING THIRD-PARTY LITIGATION FUNDING AGREEMENTS

October 2, 2024

Lawyers for Civil Justice ("LCJ")[1] and the U.S. Chamber of Commerce Institute for Legal Reform ("ILR")[2] respectfully submit this Rules Suggestion to the Advisory Committee on Civil Rules ("Advisory Committee").

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[1] LCJ is a national coalition of corporations, law firms, and defense trial lawyer organizations that promotes excellence and fairness in the civil justice system to secure the just, speedy, and inexpensive determination of civil cases. Since 1987, LCJ has been closely engaged in reforming federal procedural rules in order to: (1) promote balance and fairness in the civil justice system; (2) reduce costs and burdens associated with litigation; and (3) advance predictability and efficiency in litigation.

[2] A program of the U.S. Chamber of Commerce (the "Chamber"), ILR's mission is to champion a fair legal system that promotes economic growth and opportunity. The Chamber is the world's largest business federation, representing the interests of millions of businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations, so it is holistically dedicated to promoting, protecting, and defending America's free enterprise system.

Introduction

In the three years since the Advisory Committee last discussed third-party litigation funding ("TPLF") at its October 2021 meeting, federal judges have become increasingly aware of the need to understand TPLF agreements in their cases—particularly their control features—and have taken to employing a multiplicity of methods, often flawed, in an attempt to obtain the needed information. Now, as the Advisory Committee prepares for its October 10, 2024, discussion about "whether it has come time for the Committee to embark on what is likely to be a challenging TPLF project,"[3] this patchwork of court practices has materialized into an unpredictable procedural landscape, too often marked by reliance on mechanisms that are unsuited to the purpose, including *ex parte* conversations. Moreover, the lack of uniformity in TPLF disclosure is hampering the function of key provisions of the Federal Rules of Civil Procedure ("FRCP"), Federal Rules of Evidence ("FRE"), and other litigation principles such as real party in interest that presuppose courts and parties know who is controlling the litigation. Unfortunately, the FRCP are not neutral bystanders to these problems, but instead are (inadvertently) perpetuating them because some courts interpret Rule 26(b)(1)'s "relevance" standard to *bar* TPLF disclosure.

Courts and parties need a simple, effective, and predictable rule for TPLF disclosure. Basic judicial management requires courts to know who is in control of, and who will benefit directly from, the litigation. Parties need to know this information both so they can make a "realistic appraisal of the case, so that settlement and litigation strategy are based on knowledge and not speculation" (as the Advisory Committee said about disclosure of insurance agreements)[4] and so they can engage in settlement discussions without uncertainty over whether the named party has secretly contracted away its ability to resolve the case. Because the only way to understand TPLF agreements is to read them, the FRCP should also require disclosure of TPLF agreements.

I. DISPARATE PRACTICES ARE FILLING THE VACUUM CREATED BY THE LACK OF FRCP GUIDANCE

Now that more judges are aware of TPLF and its impact on individual cases, federal courts are casting around for the right way to inquire about TPLF agreements. Some judges ask in open court if parties are using outside funding.[5] Some have written their own standing orders;[6] some

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[3] Advisory Committee on Civil Rules, Agenda Book, Oct. 10, 2024, 419, https://www.uscourts.gov/sites/default/files/2024-10_civil_rules_agenda_book_final_9-20_at_230_pm.pdf.

[4] Fed. R. Civ. P. 26 advisory committee notes to 1970 amendment.

[5] Hr'g Tr. 12:21-24, *In re Social Media Adolescent Addiction/Personal Injury Prods. Liab. Litig.*, MDL No. 3047, ECF No. 84 (N.D. Cal. Nov. 9, 2022) ("I want to know explicitly whether you use [TPLF] or intend to use it in this case.").

[6] *See Nimitz Techs. LLC v. CNET Media, Inc.*, No. CV 21-1247-CFC, 2022 WL 17338396, at *3 (D. Del. Nov. 30, 2022) (quoting terms of standing order that "applies to all civil cases assigned to me") (Connolly, C.J.), *mandamus denied* 2022 WL 1794845 (Fed. Cir. Dec. 8, 2022); Standing Order Regarding Third-Party Litigation Funding Arrangements, https://www.ded.uscourts.gov/sites/ded/files/Standing%20Order%20Regarding%20Third-Party%20Litigation%20Funding.pdf. Report of the Parties, Standing Orders, Judge J. Philip Calabrese (N.D. Ohio), https://www.ohnd.uscourts.gov/sites/ohnd/files/Rule%2026%28f%29%20Report%20of%20the%20Parties%20%281.2.2024%29.pdf.

utilize local rules[7] and local standing orders;[8] and some are no doubt influenced by state rules.[9] Other judges require lawyers in MDL leadership positions to reveal their use of TPLF.[10] Some judges review TPLF agreements,[11] or portions of them, and at least one judge has required prior approval before lawyers can enter into TPLF agreements.[12] Still others have devised written orders requiring counsel to answer questions in writing, *ex parte*, about TPLF agreements while not requiring disclosure of the underlying agreements.[13] Problematically, some judges attempt to handle the need for TPLF information by engaging in *ex parte* discussions with plaintiffs' counsel in chambers, sometimes reviewing portions of TPLF agreements *in camera*.[14] And, incredibly at this juncture, there are still some judges who resist making any sort of inquiry whatsoever, either due to a lack of awareness or sometimes due to mis-reliance on the relevance test for discovery in Rule 26(b)(1).[15] All of these methods require judges to navigate resistance from funders, who appear to prioritize their own secrecy above all other interests.[16] This jumble of methods has produced an inconsistent and uncertain litigation environment in which parties do not know whether or how the important matter of TPLF disclosure will be handled from court to court or from case to case.

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[7] *See* D.N.J. L. Civ. R. 7.1.1(a). As the Committee is aware, "roughly half of all federal circuit courts and a quarter of all federal district courts require disclosure of the identity of (some) litigation funders for judicial recusal and disqualification purposes, indicating that such information is relevant for the just determination of a civil action by a neutral decision-maker." Memo from Patrick A. Tighe, Rules Law Clerk, to Ed Cooper, Dan Coquillette, Rick Marcus, and Cathie Struve, *Survey of Federal and State Disclosure Rules Regarding Litigation Funding* (Feb. 7, 2018), Advisory Committee on Civil Rules, Agenda Book, April 10, 2018, 209, https://www.uscourts.gov/sites/default/files/2018-04-civil-rules-agenda-book.pdf.

[8] *See* Standing Order for All Judges of the Northern District of California, Contents of Joint Case Management Statement, § 17, https://www.cand.uscourts.gov/wp-content/uploads/2023/03/Standing_Order_All_Judges-11-30-2023.pdf.

[9] States that require TPLF disclosures in litigation include: Indiana (Ind. Code Ann. § 24-12-1-0.5, et. seq.); Louisiana (*see* https://legis.la.gov/legis/ViewDocument.aspx?d=1382655); Montana (*see* MT LEGIS 360 (2023), 2023 Montana Laws Ch. 360 (S.B. 269) (enacted 2023)); West Virginia (W. Va. Code Ann. § 46A-6N-6 (enacted 2019); S.B. 850, 2024 Reg. Sess. (W.V. Mar. 9, 2024) (signed Mar. 27, 2024)); and Wisconsin (2017 Wis. Act 235, https://docs.legis.wisconsin.gov/2017/related/acts/235).

[10] *See* Case Mgmt. Order Regarding Model Leadership Appls. for Consumer Track at 2–3, *In re Marriott Int'l Customer Data Sec. Breach Litig.*, No. 8:19-md-02879-JPB, ECF No. 171 (D. Md. filed Apr. 11, 2019).

[11] *See, e.g.*, Case Mgmt. Order No. 61 (Third-Party Litigation Funding) at 1, 3, *In re 3M Combat Arms Earplug Prods. Liab. Litig.*, No. 3:19-md-02885-MCR-HTC, ECF No. 3815 (N.D. Fla. filed Aug. 29, 2023).

[12] *Id.* (prohibiting any plaintiff from "obtain[ing] third-party litigation funding, absent the filing of a motion with, and obtaining the prior approval of, th[e] [c]ourt").

[13] *See In re Nat'l Prescription Opiate Litig.*, No. 1:17-MD-2804, 2018 U.S. Dist. LEXIS 84819 (N.D. Ohio May 7, 2018) (requiring counsel to answer whether funders have "any control over litigation strategy or settlement decisions"); *In re Zantac (Ranitidine) Prods. Liab. Litig*., No. 2924, 2020 U.S. Dist. LEXIS 62805 (S.D. Fla. Apr. 3, 2020) (requiring counsel to answer whether "the litigation funder ha[s] any control . . . over the decision to file or the content of any motions or briefs, or any input into the decision to accept a settlement offer?").

[14] *See infra* section IV.

[15] *See infra* section III.

[16] Recently, after the plaintiff in *MSP Recovery Claims Series, LLC v. Sanofi-Aventis U.S., LLC*, No. 2:18-cv-02211 (BRM) (RLS), 2024 WL 4100379 (D.N.J. Sep. 6, 2024), was ordered to produce litigation funding agreements and other information, plaintiff dismissed the case entirely rather than comply.

II. SPORADIC AND INADEQUATE TPLF DISCLOSURE PRACTICES PREVENT THE NORMAL FUNCTION OF KEY FRCP PROVISIONS, EVIDENCE RULES, AND LITIGATION PRINCIPLES

The function of certain key FRCP provisions, evidence rules, and ethical rules presuppose that judges and parties know who controls or benefits directly from the litigation. These provisions cannot function as intended in the absence of TPLF disclosure. For example:

- FRCP 26(b)(1) includes "the resources of the parties" as a factor judges are to consider when deciding whether the discovery being sought is "proportional to the needs of the case." Courts cannot determine, and parties cannot advocate or respond to, the applicability of this factor without knowing whether a hidden non-party investor is providing resources to one or more parties.
- Similarly, courts and parties often must be able to identify relevant decisionmakers and to assess the parties' relative resources when determining or advocating for the appropriate allocation of costs pursuant to FRCP 26(c)(1)(B), or the imposition of sanctions under FRCP 37.
- FRCP 23 requires judges to ensure the adequacy of representation, which can be affected by a TPLF agreement.[17] Class action settlements must be "fair, reasonable, and adequate" to class members, matters that cannot determined without knowing whether a non-party investor has a contractual right to a significant portion of the proceeds.[18]
- FRE 607 provides that any party can attack the credibility of a witness who is being paid and/or has a direct interest in the outcome of the case, such as a share in the judgment or settlement proceeds. Parties are deprived of this important protection, and judges cannot enforce or oversee it, without knowing whether a TPLF agreement exists and whether a non-party financier is paying the witness.[19]
- Judges are required by statute and ethics rules to recuse when they know they have a financial interest that can pose a conflict or an appearance of one. Although TPLF investors used to be rare and obscure, "[l]egal finance has gone mainstream"[20] and "82% of law firm lawyers say they use legal finance."[21] Today, TPLF is a $15.2 billion

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[17] *See Gbarabe v. Chevron Corp.*, No. 14-cv-00173-SI, 2016 WL 4154849, at *2 (N.D. Cal. Aug. 5, 2016) (the "funding agreement [was] relevant to the adequacy [of representation] determination [required for class certification] and should be produced to [the] defendant").

[18] Only in the Northern District of California, by virtue of a Standing Order, are judges informed of this important consideration ("In any proposed class, collective, or representative action, the required disclosure includes any person or entity that is funding the prosecution of any claim or counterclaim"). Standing Order for All Judges of the Northern District of California, Contents of Joint Case Management Statement, § 17, https://www.cand.uscourts.gov/wp-content/uploads/2023/03/Standing_Order_All_Judges-11-30-2023.pdf.

[19] *Nunes v. Lizza,* No. 20-cv-4003-CJW, 2021 WL 7186264, at *6 (N.D. Iowa Oct. 26, 2021) (allowing discovery into "concern[s] that one of the witnesses in this case may be involved in funding the litigation").

[20] Burford, *Legal Finance at 15: Global Law Firm Professionals on the State of the Industry*, 3 (Oct. 1, 2024), https://www.burfordcapital.com/insights-news-events/insights-research/2024-research-legal-finance-at-15/.

[21] *Id*. at 4.

industry[22] that invests in many types of cases in all federal districts and includes public companies, foreign governments, and private individuals including ordinary people with 401(k) accounts. Rule 7.1 does not provide judges with the means to obtain necessary recusal-related information.[23]

- Parties have a right to rebut, and judges a duty to manage, a plaintiff's characterization of a case as a "David versus Goliath" situation.[24] When either the court, or the parties, are unaware that a TPLF agreement provides significant resources to the party claiming to be the "David," neither the court nor the parties can give meaning to this right. TPLF secrecy should not be used as a sword by those who claim it as a shield.
- When courts and parties do not know who stands to benefit directly from the judgment or settlement in a case, courts cannot administer, and parties do not have the protection of, the FRCP 17(a)(1) requirement that "[a]n action must be prosecuted in the name of the real party in interest."[25]

Because each of these rules and principles requires that courts and parties know who controls and stands to benefit from the litigation, they cannot be applied fully or uniformly in the absence of a uniform procedure for disclosure of TPLF agreements.[26]

III. RULE 26(b)(1)'s "RELEVANCE" STANDARD IS CONFUSING COURTS ABOUT THEIR NEED AND ABILITY TO ORDER TPLF DISCLOSURE

Some courts see Rule 26(b)(1) as barring the disclosure of TPLF agreements as not "relevant to the claims and defenses."[27] Such courts have expressed skepticism that TPLF information is

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[22] Westfleet Advisors, *The Westfleet Insider 2023 Litigation Finance Market Report*, https://www.westfleetadvisors.com/wp-content/uploads/2024/03/WestfleetInsider2023-Litigation-Finance-Market-Report.pdf.

[23] Lawyers for Civil Justice and the U.S. Chamber of Commerce Institute for Legal Reform, *A Necessary Disclosure: Why Rule 7.1 Should Provide Judges Information About Non-Party Contingent Financial Interests that Could Require Recusal*, March 14, 2024, https://www.uscourts.gov/sites/default/files/24-cv-d_suggestion_from_lcj_and_ilr_-_rule_7.1.pdf.

[24] *Nunes, supra* n.19 (third-party funding likewise "relevant to respond to a 'David vs. Goliath' narrative").

[25] *MSP Recovery v. Sanofi*, 2024 WL 4100379 at *6 ("litigation funding [is] … relevant in determining the real party in interest for this litigation"); *Nimitz Techs.*, 2022 WL 17338396 at *3 ("The Disclosure Order [concerning third-parry funding] also promotes the identification of the real parties in interest in a case."); *Nunes*, 2021 WL 7186264 at *5 (plaintiff's "lack of knowledge about who is paying the attorneys prosecuting this action raises legitimate concern about not only who may be in charge of the lawsuit, but also whether Plaintiffs are the still the real parties in interest"); *FastShip, LLC v. United States*, 143 Fed. Cl. 700, 716-17 (Ct. Cl. 2019) (litigation funding bears on determining real party in interest), *vac. on other grounds*, 968 F.3d 1335 (Fed. Cir. 2020).

[26] Further, a party's motive for pursuing litigation is also a substantive element of certain causes of action, such as SLAPP litigation and abuse of process, and third-party litigation funding is thus relevant in such litigation. *E.g. Smartmatic USA Corp. v. Fox Corp.*, No. 151136/2021, 2023 WL 2626882, at *2 (N.Y. Sup. Mar. 24, 2023) (litigation finance discoverable in SLAPP litigation).

[27] *E.g.*, *GoTV Streaming, LLC v. Netflix, Inc.*, No. 2:22-cv-07556-RGK-SHK, 2023 WL 4237609, at *11 (C.D. Cal. May 24, 2023); *Art Akiane LLC v. Art & Soulworks LLC,* No. 19 C 2952, 2020 WL 5593242, at *6 (N.D. Ill. Sep. 18, 2020); *In re Valsartan N-Nitrosodimethylamine (NDMA) Contamination Prod. Liab. Litig.*, 405 F. Supp.3d 612, 615 (D.N.J. 2019); *Fulton v. Foley*, No. 17-CV-8696, 2019 WL 6609298, at *2 (N.D. Ill. Dec. 5, 2019); *Benitez v. Lopez*, 17-CV-3827-SJ-SJB, 2019 WL 1578167, at *1 (E.D.N.Y. Mar. 14, 2019); *MLC Intellectual Property LLC v. Micron Tech., Inc.*, No. 14-cv-3657-SI, 2019 WL 118595, at *2 (N.D. Cal. Jan. 7, 2019); *Space Data Corp. v.*

relevant to the litigation[28] or affects the merits of individual claims and defenses.[29]

The Advisory Committee considered—and rejected—a similar analysis when it promulgated a rule requiring disclosure of insurance agreements in 1970. The Advisory Committee determined that Rule 26(b) "relevancy" analysis should not limit the disclosure of insurance agreements, instead concluding that policy considerations require the mandatory disclosure of insurance agreements.[30] The Advisory Committee observed that many courts were rejecting discovery requests for insurance agreements "reason[ing] from the text of Rule 26(b) that it permits discovery only of matters which will be admissible in evidence or appear reasonably calculated to lead to such evidence."[31] The Advisory Committee noted that those courts "avoid[ed] considerations of policy, regarding them as foreclosed."[32]

The Advisory Committee should act consistently today by acknowledging that disclosure of TPLF agreements is not governed by Rule 26(b)(1) and by promulgating a uniform rule defining the procedure for TPLF disclosure. As was the case with disclosure of insurance coverage, this "will enable counsel for both sides to make the same realistic appraisal of the case, so that settlement and litigation strategy are based on knowledge and not speculation."[33]

IV. COURTS NEED FRCP GUIDANCE TO AVOID THE INAPPROPRIATE DEFAULT USE OF *EX PARTE* CONVERSATIONS

In the absence of FRCP guidance, some federal courts are resorting to *ex parte* conversations with plaintiffs' counsel. In secret, these judges are informally asking lawyers if they are using

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Google LLC, No. 16-cv-03260 BLF, 2018 WL 3054797, at *1 (N.D. Cal. Jun. 11, 2018); *Ashghari-Kamrani v. United Serv. Auto. Ass'n*, No. 2:15-CV-478, 2016 WL 11642670, at *4 (E.D. Va. May 31, 2016); *Kaplan v. S.A.C. Capital Advisors, L.P.*, No. 12-CV-9350 (VM)(KNF), 2015 WL 5730101, at *5 (S.D.N.Y. Sep. 10, 2015), *adopted*, 141 F. Supp. 3d 246 (S.D.N.Y. 2015); *Yousefi v. Delta Electric Motors, Inc.*, No. 13-CV-1632 RSL, 2015 WL 11217257, at *2 (W.D. Wash. May 11, 2015); *Miller UK Ltd. v. Caterpillar, Inc.*, 17 F. Supp. 3d 711, 729 (N.D. Ill. 2014).

Of course, other courts have found that TPLF agreements are relevant to claims and defenses, including where it can lead to evidence of the value of a plaintiff's claims (most frequently in medical and patent cases). *See Hobbs v. Am. Comm. Barge Line LLC,* No. 4:22-cv-00063-TWP-KMB, 2023 WL 6276068, at *4 (S.D. Ind. Sep. 26, 2023) (compelling discovery of third-party funding because "[e]vidence related to the actual value of Mr. Hobbs' injuries is relevant not only as the parties prepare for trial but also to explore settlement possibilities"); *Taction Tech., Inc. v. Apple Inc.,* No.: 21-cv-00812-TWR-JLB, 2022 WL 18781396, at *5 (S.D. Cal. Mar. 16, 2022) ("This Court agrees with other courts in this district that have found litigation funding agreements and related documents can be directly relevant to the valuations placed on the patents prior to the present litigation."); *Preservation Techs. LLC v. MindGeek USA, Inc.*, No. 2:17-cv-08906-DOC-JPR, 2020 WL 10965161, at *6 (C.D. Cal. Dec. 18, 2020) ("litigation funding documents are relevant to assessing the value of the disputed patents in this suit").

[28] *Art Akiane*, 2020 WL 5593242 at *6 (information about litigation funding requires "some detailed, meaningful explanation to satisfy the requirement of relevancy"); *GoTV Streaming,* 2023 WL 4237609 at *11 ("Though the Court empathizes with Netflix's desire to obtain this information, allowing this to be the standard would require this Court to ignore the controlling limits under Rule 26."); *Fulton,* 2019 WL 6609298 at *3 ("settlement considerations are a wholly distinct concept and not a proper basis to obtain discovery under Rule 26(b)(1)").

[29] *Fulton*, 2019 WL 6609298 at *2 ("As a general matter, courts across the country that have addressed the issue have held that litigation funding information is generally irrelevant to proving the claims and defenses in a case.").

[30] Fed. R. Civ. P. 26 advisory committee notes to 1970 amendment.

[31] *Id.*

[32] *Id.*

[33] *Id.*

TPLF and, if so, if they have ceded day-to-day control over their case—and probably accepting the lawyers' assurances.[34] These courts are, in effect, reaching legal conclusions about the control features of a contract that could affect all parties to the litigation without the benefit of adversarial arguments from other parties about the meaning of the TPLF agreement.[35] Such an informal and one-sided method is not only highly unlikely to elicit candor and specificity about the key provisions in a TPLF agreement, but also compromises the credibility of the judicial process. The Code of Conduct for U.S. Judges generally prohibits *ex parte* communications and further states that judges who receive *ex parte* communications on a substantive matter "should promptly notify the parties of the subject matter of the communication and allow the parties an opportunity to respond."[36] The exceptions to the general prohibition "when circumstances require" are "scheduling, administrative, or emergency purposes."[37] A court's effort to understand the control features of a TPLF contract or to decide whether to allow discovery on this issue does not fall into any of these categories.[38] The Advisory Committee should not accept *ex parte* communications as the regular, routine procedure for federal court inquiries into TPLF agreements.

In camera review of limited portions of a TPLF agreement[39] does not remedy the problems. Rather, it enhances the risk that the judge has less than all of the relevant information needed to reach a conclusion about the operation of the contract.

Importantly, the *ex parte* approach to handling TPLF issues is preventing any potential development of case law concerning the increasingly common and complex legal questions about TPLF agreements, including what constitutes "control." Currently, critical issues relating to TPLF come to light only when conflicts between funders and their clients boil over.[40]

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[34] Lawyers who receive non-party funding obviously have a strong interest in serving the interests of their funders.

[35] *See, e.g., GoTV Streaming,* 2023 WL 4237609 at *13; *Nunes,* 2021 WL 7186264 at *6; *United Access Techs., LLP v. AT&T Corp.*, C.A. No. 11-338-LPS, 2020 WL 3128269, at *1 (D. Del. Jun. 12, 2020) ("Generally, when confronted with this sort of dispute, close consideration of the subject matter in the disputed documents (e.g., through *in camera* review) is a prudent approach.").

[36] Code of Conduct for U.S. Judges, Canon 3(A)(4).

[37] *Id.*

[38] If the purpose of *ex parte* communications about TPLF agreements is to protect the privacy of the non-party, then the practice runs afoul of the judiciary's strong presumption that interested parties proceed in their own name, which can be overcome only by a showing of "a substantial privacy right which outweighs the 'customary and constitutionally-embedded presumption of openness in judicial proceedings.'" *Plaintiff B v. Francis*, 631 F.3d 1310, 1315–16 (11th Cir. 2011) (citations omitted).

[39] *E.g.*, *3rd Eye Surveillance, LLC v. United States*, 158 Fed. Cl. 216, 228 (Ct. Cl. 2022).

[40] *E.g.*, *In re Pork Antitrust Litig.*, No. CV 18-1776 (JRT/JFD), 2024 WL 2819438, at *4 (D. Minn. Jun. 3, 2024) ("Permitting a litigation funder to step into the shoes of its client via assignment and substitution would contravene the purpose of antitrust laws and standing requirements by condoning third parties with only investment interests to take over and litigate antitrust cases…. [C]ourts must still be careful to ensure that litigation financiers do not attempt to control the course of the underlying litigation. Sysco and Burford's conduct is precisely the kind of conduct of which courts are wary. The substitution motion directly resulted from their attempt to resolve the dispute over whether Sysco or Burford should control this litigation. The Court will not approve such conduct.").
In the *Gbarabe* litigation, a similar dispute revealed a litigation funding agreement that contained several key provisions by which the funder sought to influence the course of litigation, including prohibiting the lawyers from engaging co-counsel or experts without the funder's consent. *See Gbarabe v. Chevron Corp.*, No. 3:14-cv-00173-SI, ECF No. 186-4, at 69-91 (N.D. Cal. filed Sep. 16, 2016).

V. COURTS AND PARTIES NEED FRCP GUIDANCE THAT THE DETERMINATION OF CONTROL REQUIRES DISCLOSURE OF TPLF AGREEMENTS

It is widely understood that TPLF agreements can give control of litigation and settlement to non-parties.[41] Effective case management requires federal courts to know—and allow parties to know—if any TPLF agreement in their case takes control away from named parties and give it to unknown investors. Judges need to understand who is controlling litigation decisions so that they may require the actual decisionmakers to participate in, or be available during, settlement conferences and other pre-trial proceedings. Judges also need to know whether TPLF is harming named plaintiffs by siphoning off their recovery—especially in class action cases, where Rule 23 requires judges to ensure the adequacy of representation and that settlements are "fair, reasonable, and adequate" to class members. Judges (and the public) also should know whether TPLF is being employed by foreign adversaries to undermine the interests of the United States, gain access to sensitive information, or to evade sanctions.[42]

Parties need to know who is in control in order to make informed decisions about the litigation and engage in settlement discussions. When litigation funders hide in the shadows, "the settlement process often unravels when the nominal plaintiff or its counsel needs to obtain approval from undisclosed non-party funders or uses the non-party as an excuse to retract a commitment to settle."[43] Effective case management is thwarted when arbitration or separate litigation is needed to determine whether a named party has the right to settle its case, make certain litigation decisions, or even choose its own lawyer.[44]

A. Control Can Be Determined Only by Understanding the TPLF Agreement

Determining whether a TPLF agreement gives a non-party material influence or control over the litigation and potential resolution is more complicated than it might seem. TPLF agreements are typically lengthy and contain both significant control features and boilerplate recitations disavowing any delegation of control. Judges who ask lawyers yes/no questions about whether they have given funders control over litigation strategy or settlement decisions learn almost nothing about the actual nature of the TPLF agreement; they certainly do not learn whether a funding agreement vests a non-party funder with authority to influence or control the litigation.[45]

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[41] *See, e.g., Pork Antitrust Litig.*, 2024 WL 2819438 at *3–4; *Boling v. Prospect Funding Holdings, LLC*, 771 F. App'x 562, 579–80 (6th Cir. 2019) (terms of the funding agreements "effectively g[a]ve [a TPLF entity] substantial control over the litigation," including terms that "may interfere with or discourage settlement" and otherwise "raise[d] quite reasonable concerns about whether a plaintiff can truly operate independently in litigation"). *See also* U.S. Chamber of Commerce Institute of Legal Reform, *Grim Realities: Debunking Myths in Third-Party Litigation Funding*, Aug. 2024, https://instituteforlegalreform.com/wp-content/uploads/2024/08/TPLF-Grim-Realities-8.29.24.pdf.

[42] *Grim Realities*, https://instituteforlegalreform.com/wp-content/uploads/2024/08/TPLF-Grim-Realities-8.29.24.pdf.

[43] Letter from 124 companies to H. Thomas Byron III, Secretary, Committee on Rules of Practice and Procedure (Oct. 2, 2024) ("124 company letter").

[44] *See, e.g.*, *Pork Antitrust Litigation*, *supra* n. 40.

[45] *See Nimitz Techs.*, 2022 WL 17338396 at *18 (litigation funders discovered to be involved to such an extent that the "plaintiffs" made none of their own decisions). The judge suspected that the funders had "perpetrated a fraud on

Control features are unlikely to be express provisions; instead, they often are a function of how the contract operates. For example, language providing that the funder will "not unreasonably withhold consent" to settlement or certain other decisions in the litigation may not jump off the page as ceding control to a non-party. But such language can amount to a disguised veto power over the named party's decisions. Critical examination is key.

It is also important to understand how the continuation of funding works; a provision describing funding in steps or tranches can be a powerful mechanism of control because it can exert strong pressure on the named parties and their counsel to make certain decisions (*e.g.*, not to pursue a settlement on terms that do not satisfy the funder's desire for investment returns) or face the termination of funding. A court cannot understand the operative details via a cursory discussion or partial reading; it must have the benefit of a full vetting that can only come through the adversarial process.

B. Understanding is Achieved Only by Disclosing TPLF Agreements to Parties

Parties—who have their own right to know who controls the litigation—should be able to provide information, argument, and perspectives to the court about the meaning of TPLF agreements that may affect them. As 124 companies have told the Advisory Committee, "we cannot understand the control features of a TPLF agreement without reading the agreement." [46] As one court has observed, "disclosure of [litigation funding] agreements ... encourage[s] transparency and ensure[s] a shadow broker is not using litigation as a form of harassment or for multiple bites at the same apple."[47]

C. Supplementation is Critical to TPLF Disclosure

Any inquiry into TPLF agreements or disclosure order that takes place only once during litigation—usually at a very preliminary stage—is very likely to fail in its purpose. TPLF agreements can arise at any time during a case, and can change dramatically over the course of litigation, even after a settlement in principle, so supplementation of any representations or disclosures is essential.[48]

Conclusion

The answer to whether it is "time for the Committee to embark" on rulemaking concerning TPLF disclosure[49] is a resounding "yes." Any reservations that this will prove too challenging, or require a great deal more education, are unfounded. The Advisory Committee has done extensive work since 2014 and now it is clear that judges and parties recognize the need to know who controls and stands to benefit directly from their cases. The observation that judges have

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the court" "designed to shield" themselves "from the potential liability they would otherwise face ... in litigation." *Id.* at *26.

[46] 124 company letter.

[47] *FastShip*, 143 Fed. Cl. at 717.

[48] *See WFIC, LLC v. LaBarre*, 148 A.3d 812, 814–15 (Pa. Super. 2016) (detailing evolution of litigation funding agreements during the course of litigation).

[49] Advisory Committee on Civil Rules, Agenda Book, Oct. 10, 2024, 419, https://www.uscourts.gov/sites/default/files/2024-10_civil_rules_agenda_book_final_9-20_at_230_pm.pdf.

authority to require disclosure of TPLF when warranted does not suffice. A uniform rule is necessary to remedy the hodgepodge of practices and default reliance on unsuitable methods including *ex parte* conversations.

Without such guidance, key provisions of the FRCP, FRE, and other judicial principles will be increasingly ineffective and dysfunctional, and FRCP 26(b)(1) will continue to exacerbate the problem. The only way to achieve the necessary familiarity with how litigation funding impacts particular litigation is through review of the actual TPLF agreements. The Advisory Committee should undertake to draft and adopt a straightforward, uniform rule for TPLF disclosure—one that allows courts and parties to understand TPLF agreements—so courts, parties, and non-parties know what the procedure will be in all federal courts.

From: Levy, Robert L <robert.l.levy@exxonmobil.com>
Sent: Wednesday, October 16, 2024 2:24 PM
To: Harvey Brown <Harvey.Brown@LanierLawFirm.com>; John Kim <jhk@thekimlawfirm.com>; Marcy Greer <mgreer@adjtlaw.com>; jbrowning@faulkner.edu; Connie Pfeiffer <cpfeiffer@yettercoleman.com>
Subject: Fwd: Bloomberg Law: Fortress' Billions Quietly Power America's Biggest Legal Fights

An interesting article on TPLF (apologies for the highlighting)

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Fortress' Billions Quietly Power America's Biggest Legal Fights

- Fortress describes litigation finance strategy in depth for first time
- Asset management giant commits $6.6 billion to legal assets, $2.9 billion to IP

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Fortress has taken over funders when financing arrangements went sour.

It contributed with other creditors to a loan to Vannin Capital amounting to a total debt of £88 million in 2018, just as the industry was taking shape. Vannin planned to go public that same year, but the IPO fell through, and Fortress told Vannin's founders to kick in more equity or find a buyer. They opted for the latter. Fortress bought Vannin and then let go its US staff, though it retained some employees in Europe and Australia.

Affiniti Capital Management, a UK-based lender to law firms, received a £30 million loan from Fortress in 2020. A year into the deal, Neumark said, Fortress started to lack confidence in Affiniti's reporting and the quality of the underlying portfolio.

"Ultimately we had to pull the trigger and put it into administration and take it over so that we could get closer to the assets," Neumark said.

He says Fortress invested around £25 million or £30 million and will probably get back between 20 and 35 percent of that investment.

"Across Fortress and every asset manager you lose money occasionally, and this is definitely the one that there's a strong chance we're going to lose some money on," he said.

The former CEO of Affiniti, Ian Cunningham, refuted the allegations about the portfolio and said Fortress never mentioned reporting issues.

What's next?
Fortress has closed out about 40% of its litigation finance deals, Neumark said. On the deals that haven't fully realized, it's returned a significant amount of capital to investors.

"As long as people are happy with the product, I think there's going to be more and more uptake and so I think the asset class is going to grow for sure over time," he said. "I just don't know how much."

The criticism "does bother me," Neumark said. "There's a lot of defaulting to ambulance chasers or things like that. And when you're talking about big antitrust litigation or big product liability litigation, like, there's really no margin for doing stuff that's frivolous."

In their view, they are Davids. Even with billions of dollars behind them, they reason, the Goliaths have more billions.

But that's as far of a biblical reference as they'll go.

"My business does believe in going and helping those who cannot be funded otherwise," IP lead Zur said. "But no, I don't do God's work here. I don't want to pretend like I am putting on the white hat."

Business & Practice
Oct. 16, 2024, 4:01 AM CDT

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By Emily R. Siegel

Exclusive

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WATCH: Making Millions Off Others' Lawsuits: How Litigation Finance Works

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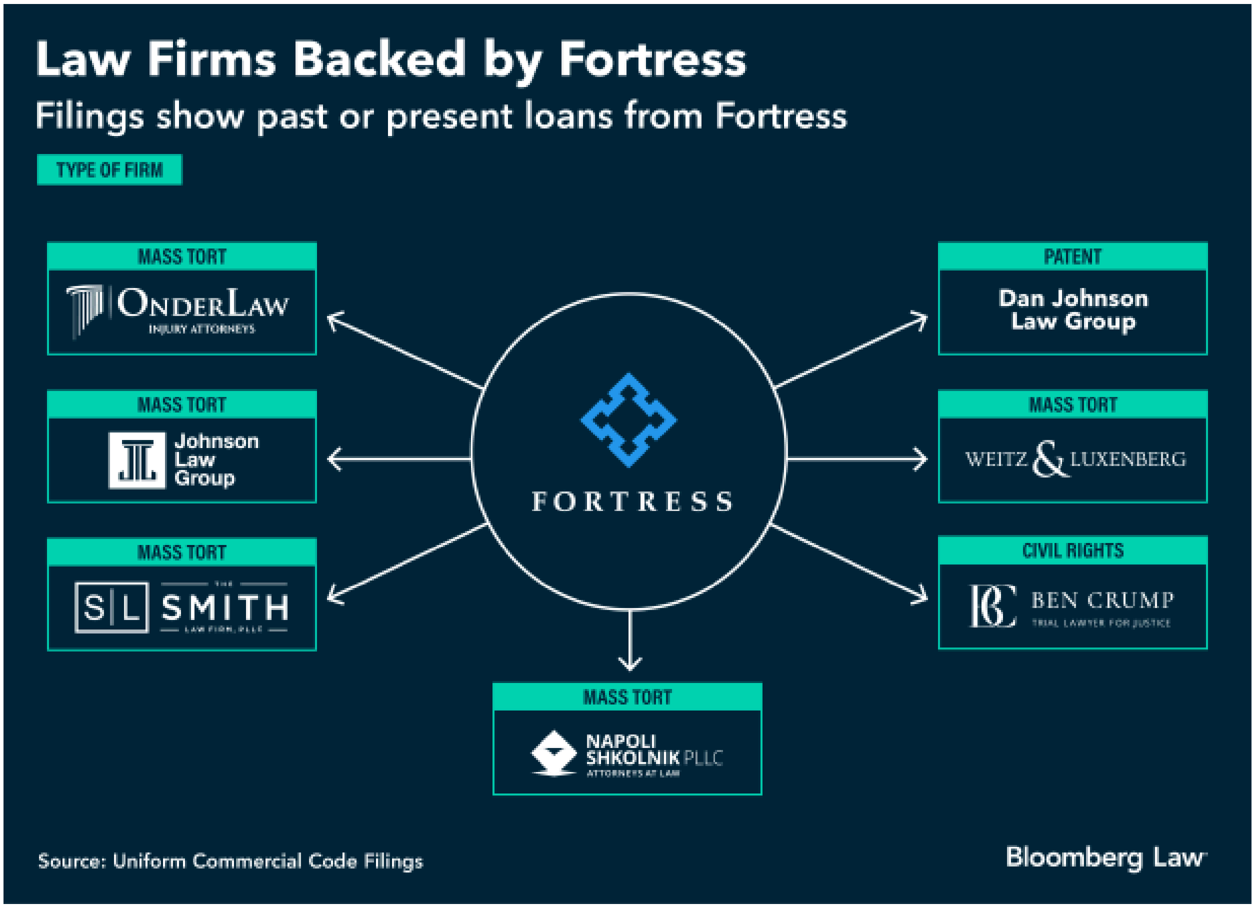

Law Firms Backed by Fortress

Filings show past or present loans from Fortress

Source: Uniform Commercial Code Filings

Graphic: Jonathan Hurtarte/Bloomberg Law

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Subject: Fwd: Bloomberg Law: Fortress' Billions Quietly Power America's Biggest Legal Fights

An interesting article on TPLF (apologies for the highlighting)

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Fortress' Billions Quietly Power America's Biggest Legal Fights

- Fortress describes litigation finance strategy in depth for first time

- Asset management giant commits $6.6 billion to legal assets, $2.9 billion to IP

The easy explanation for how Fortress Investment Group worked its way to the top of the polarizing, opaque business of litigation funding would be: It has a ton of money.

With about $6.6 billion committed to legal assets, Fortress backs law firms behind some of history's biggest mass tort suits, such as the Roundup cases against Bayer AG and talcum powder litigation against Johnson & Johnson. It funds other litigation funders.

And with another $2.9 billion committed to intellectual property, the asset-management giant claims to be the world's largest institutional investor in patents.

But its secret may be its intensity and a meticulous streak that comes with all of that money.

As a patent owner, Fortress aggressively pursues alleged infringers in court, making it a thorn in the side of tech giants like Apple Inc. and Intel Corp. In litigation funding, law firms that take money from Fortress have their bank accounts tracked weekly and their cases monitored closely. One litigation funder said he passed on taking money from Fortress because “they choke you to death.”

Told that a person in the industry described Fortress as “pirates,” the firm’s intellectual property lead, Eran Zur, joked to a reporter that he forgot his eye patch that day.

“We’re a tough counterparty if you don’t do what you say you’re gonna do,” Jack Neumark, a Fortress managing partner and co-CIO, said during a nearly three-hour interview in which Fortress discussed litigation finance activities in depth for the first time. “We see where funds go. If you do something you’re not supposed to do, we’re gonna be upset.”

Once on the fringes of alternative investing, backing lawsuits to get a piece of the outcome has become a multi-billion-dollar, lightly regulated industry. Funders like to keep their activities close to the vest: In 2022, a Fortress-backed patent entity withdrew a $4 billion lawsuit against Intel after a judge ordered it to identify its financial backers.

The occasional huge payoff aside, litigation finance is not an easy way to make money. Funders are at the mercy of the legal system’s pace. Some states and judges have tried to force funders to operate more openly. The US Chamber of Commerce has for years fought an industry it views as funding frivolous lawsuits against its members.

Congress has tried at least four times to pass legislation that would regulate the industry. One of the proposed bills could have put Fortress out of the legal assets business.

“I’m continually confused as to why someone decided that this was the most credible threat that they could have come up with,” Neumark said.

Who They Fund

Fortress has $48 billion in assets under management and recently said it expects to double that. It launched in 1998 as a private equity boutique and moved into credit and real estate. In 2007, it became the first alternative-investment manager to go public. Ten years later, Fortress was acquired for $3.3 billion by Softbank Group Corp., which earlier this year completed the sale of its remaining 90.1% equity to Fortress management and Abu Dhabi’s sovereign wealth fund, Mubadala Investment Co.

It’s acquired and resold name-brand institutions, many of them in distress, in a variety of industries over the years. Most recently, it acquired Red Lobster and Vice Media out of bankruptcy. Less well known is how it’s steadily built its litigation finance business, which has 32 employees making the calls on where to deploy capital. Its intellectual property arm has a separate team of 19 employees.

Burford Capital Ltd.,one of two publicly traded funders, is often considered the face of the industry. It backed shareholders who won a $16 billion judgmentagainst Argentina, one of the largest jury awards ever in the Southern District of New York.

Burford’s life-to-date commitment number for its balance sheet and private funds is around $10.7 billion since its launch in 2009. But it mainly invests directly in commercial litigation, something Fortress rarely does. Burford issues non-recourse commercial funding and focuses on valuing litigation risk, while Fortress has a credit-like approach.

Mass tort firms are a huge part of Fortress’ law lending and have emerged as an increasingly popular area for litigation funders.

What started as $5 million to $10 million investments in single commercial cases has grown into loans exceeding $100 million to law firms for their entire caseloads. It’s a built-in diversified portfolio that hedges risk.

“When we encounter mass tort law firms, the name we hear frequently as to where they have financed their portfolios today or historically, you’ll hear Fortress more often than any other,” said David Perla, Burford Capital’s vice chair. “They’re aggressive, they’re smart, they understand the space.”

A review of Uniform Commercial Code filings by Fortress over the past decade found seven law firms to which it has provided loans, some of which have terminated. The filings don’t specify the amount of the loans or how the money is used but offer a glimpse into how firms do business with Fortress. Fortress wouldn’t comment on the transactions.

They include Texas-based Johnson Law Group. The firm’s founder, Nick Johnson, also owns a litigation funding company called Armadillo Litigation Funding that has been a Fortress partner. Johnson Law is involved in many major mass tort cases, including talcum powder, Camp Lejeune toxic-water claims, and sexual-assault claims against Uber Technologies Inc.

Nick Johnson and Johnson Law Group didn’t respond to requests for comment.

Partners in Napoli Shkolnik are on executive and steering committees for many of the biggest mega-cases, including ones over PFAS water contamination and opioids. Napoli said it no longer has a loan with Fortress but credits the asset manager with putting it on a self-sustaining path.

“Their partnership was critical to our past achievements, and we’re grateful for their support,” the firm said in a statement.

It also previously loaned to the Smith Law Firm, a co-counsel of Beasley Allen, which has led the J&J talc litigation; St. Louis based OnderLaw; and personal injury firm Weitz & Luxenberg.

Neither Smith Law nor Onder Law responded to requests for comment. Weitz & Luxenberg declined to comment.

In 2020, California-based Dan Johnson Law Group had a lien with Fortress. Dan Johnson said the firm had a small funding effort during the pandemic.

Mike Papantonio of Florida mass tort law firm Levin Papantonio says his firm has a line of credit with Fortress for only operational expenses. He said they don’t use any of it for case acquisition.

“They’re nothing but a bank to us and we may choose to use their credit line or not,” he said.

Fortress has also loaned to firms with specializations other than mass torts, the UCC filings show. One is the firm of civil rights lawyer Ben Crump, who represented the families of George Floyd, Trayvon Martin, and Breonna Taylor. Crump Law didn’t respond to requests for comment.

When Fortress lends to a law firm, it keeps a close eye on how its money is used.

“There are good lenders and bad lenders, and I think there are some bad loans out there in the mass tort space,” Neumark said. “I think one of the major traps that people get sucked into is not having the resources internally to do a thorough review of the files.”

The ‘Super Funder’

In the litigious world of intellectual property, Fortress works with companies that own undervalued patents or acquires patents from companies that are cash poor but invention rich. Then it identifies operating companies allegedly infringing the patents, seeking license payments from those willing to pay or jury verdicts from those who aren’t.

“I do believe we pioneered the patent lending business,” said Zur, who co-founded RPX, a provider of patent risk management services with a number of the world’s biggest tech companies as paying members. “It existed as a concept before we did this, but it wasn’t an active investment with large financial institution money behind it.”

Fortress first began investing in IP with its General Opportunities Fund, dedicating an $800 million component to the sector. It then raised two closed end funds: $900 million for its first bespoke IP fund and $1.25 billion for its second.

But Zur doesn’t consider himself a litigation funder.

“We do not invest passively as opposed to litigation funders. It’s private equity. We sit on the board, we advise,” Zur said.

Jonathan Stroud, general counsel at Unified Patents, a membership organization with a mission to deter abusive patent assertions, says Fortress’ claim to not be an IP litigation funder is “weird.”

“Because you have more control of the entities, it doesn’t mean you’re not a funder, you’re a super funder.” he said. “You’re funding the case and you’re a client.”

The likes of Apple and Intel have special animus for entities like Fortress that sue over patents they own but don’t use in a product or service. Officially, they refer to them as non-practicing entities. The less flattering term is patent troll.

Ironically, it’s a term used in Zur’s writing.

In 2015, he co-wrote an article, titled “Why Investment-friendly Patents Spell Trouble for Trolls,” that Big Tech opponents have tried to use against him. Intel, in one court brief, used Zur’s words to argue how Fortress takes advantage of the court system.

“These oversized awards stem from the sheer complexity of interoperable components and systems sold as part of functional units, if not integrated devices,” he wrote. “And because technology invention tends to be incremental, to the extent an individual patent owner can be awarded damages on the price of the entire end product as opposed to their specific patent claim, a litigation incentive arises.”

Asked about his foes turning his words against him, Zur joked that he’s flattered.

Given the chance to write the article over, he said, he might be more judicious. “But, you know,” he said, “I can’t take it back.”

Patent Disclosure

One of Fortress’ patent-assertion entities is VLSI Technology LLC, which owns a portfolio of patents that formerly belonged to Dutch chipmaker NXP Semiconductors NV.

VLSI obtained two jury verdicts for patent infringement totaling more than $3 billion against Intel, one of which was partially reversed. In a third case before Delaware District Judge Colm F. Connolly,who often oversees patent cases in one of the most popular venues for that litigation, VLSI was seeking $4.1 billion against Intel.

VLSI brought that case in 2018, four years before Connolly issued a standing order requiring disclosure of litigation finance agreements. The judge nonetheless sought to enforce his mandate. Told to disclose its owners, VLSI said there were 10, describing them as pension, retirement, and sovereign wealth investments, foundations, high net worth individuals, and endowments.

Connolly wanted names and put the case on hold until VLSI complied. A few months later, VLSI dropped the case. Zur declined to say if the case was dropped due to the disclosure requirement.

“Any judge who’s asking us ‘who are your investors?’ I say, okay, but who are Apple’s investors? I mean, what’s the difference?” Zur said. “Does the identity of the plaintiff or the characteristics of the plaintiff matter in a patent claim?”

Intel declined to comment, and Apple didn’t respond to requests for comment.

The Disclosure Battle

The Chamber has pressed, with mixed results, for state and federal legislation requiring more disclosure of funding arrangements. Louisiana, Indiana, and West Virginia have passed legislation in various forms, while proposals died in Florida and Kansas.

“We’re not fearing disclosure, but I just worry it distracts the judge or delays the case and ultimately results in the defendants being able to create more leverage to slow down a verdict or a settlement that is ultimately going to benefit the plaintiff,” Neumark said.

The Chamber has also called litigation funding a national security risk. In 2022, its Institute for Legal Reform published a paper describing how adversaries like China and Russia could fund lawsuits to obtain confidential information on US companies. The paper was largely theoretical and didn’t cite examples. But since it was published, Bloomberg Law has identified Russian and Chinese funders that have operated in the US court system. Among them is A1 LLC, a subsidiary of Russia’s Alfa Group that has been under US sanctions since September 2023.

Last year, Sens. Joe Manchin (I-W. Va.)and John Kennedy (R-La.)introduced the Protecting Our Courts from Foreign Manipulation Act. The bill would have required disclosure from a foreign person or entity funding litigation in federal courts.

The legislation also would have banned sovereign wealth funds and foreign governments from participating in litigation finance. That would have effectively banned Fortress from the business, given Mubadala’s 68 percent ownership. Fortress said it controls its board of directors and balance sheet, and is autonomous in its business operations.

Neumark called the proposed law, which died in committee, a transparent effort to stop lawsuits against corporations. Litigation funding “might be the most inefficient way possible for a foreign entity to try to gain access to confidential information,” he said.

Sen. Chuck Grassley (R-Iowa) has twice, unsuccessfully, introduced the Litigation Funding Transparency Act. The latest legislation was introduced in the House by Rep. Darrell Issa (R-Calif.) this month, after the House Judiciary Committee in June held a hearing on litigation finance in the IP space.

In October, the US Judicial Conference’s Advisory Committee on Civil Rules agreed to study the rules requiring disclosure of litigation funding.

“As much as 30% of patent litigation could be funded by third parties, and that number could be even higher because there is no uniform disclosure requirement for litigation funding agreements,” said Stephen Waguespack, president of the US Chamber of Commerce Institute for Legal Reform. “Without transparency, judges, defendants, and even plaintiffs do not know who is funding or possibly controlling US patent litigation cases, which could undermine US economic and national security. It is time to bring third-party litigation funding out of the shadows."

Funder Takeovers

One of the tightly held aspects of Fortress' business is how it funds other litigation funders.

A person with knowledge of investor arrangements, who declined to be named due to confidentiality agreements, said that they're aware of at least four funders who've received capital from Fortress.

Neumark won't confirm that but said Fortress' funding to funders can take the forms of debt, investing in general partners, or partnering on an investment.

One consistent principle is that if Fortress agrees to provide capital to a funder, it will be hands on.

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I. Executive Summary

A. Creation and Charge of the Task Force

The Arizona Supreme Court has constitutional authority to establish court procedures and to regulate the practice of law.

In 2021, the Supreme Court authorized the creation of Alternative Business Structures ("ABSs") defined as a "business entity that includes nonlawyers who have an economic interest or decision-making authority in the firm and provides legal services in accord with Supreme Court Rules 31 and 31.1(c)." To date, 100 ABSs have been approved, and there are additional applications pending. Evaluation of the program is warranted based on the experiences gained during these first few years to determine if any adjustments need to be made to the governing code.

On March 18, 2024, then-Chief Justice Robert Brutinel issued Administrative Order No. 2024-51, which established the ABSs Task Force (the "Task Force"). The order stated that the purpose of the Task Force is to evaluate the program allowing for the creation of ABSs and propose amendments to the Arizona Code of Judicial Administration ("ACJA") and court rules as appropriate. Specifically, the Task Force is directed to evaluate the program and proposed amendments to the ACJA and court rules as appropriate, and to determine whether:

- additional disclosures should be made for those funding ABSs;
- it is acceptable for ABSs to be approved for the sole purpose of soliciting mass tort business; and
- ABSs must provide substantial services to people in Arizona.

On July 3, 2024, Chief Justice Ann A. Scott Timmer issued Administrative Order No. 2024-136, ordering the Task Force to examine third-party funding of civil litigation and its ramifications for ABSs. The order directed the Task Force to include any related proposals in its report and recommendations. Generally speaking, third-party litigation funding is a practice by which a non-party provides funding to a litigant or law firm either for profit, or some other motivation.

The Task Force was directed to submit its report and recommendations to the Arizona Judicial Council (the "AJC") at its meeting in October 2024. The report that follows consists of the Task Force's recommendations for the AJC's review and consideration. The report was approved by all Task Force members, with member Page Faulk dissenting.

B. The Task Force Process

Members of the Task Force represented a wide variety of perspectives on third-party litigation funding. A few original members from the Task Force on the Delivery of Legal Services were appointed, along with other legal industry leaders. Information about how local, national, and international leaders are examining, exploring, and implementing legislation or court rules was a regular part of the information shared at monthly meetings. The Task Force met once a month from April through September 2024, discussing the issues outlined by Administrative Order Nos. 2024-51 and 2024-136 and their charges.

Early on, the Task Force benefitted from discussions with Crispin Passmore, renowned United Kingdom ABSs expert; John Beisner, a Washington D.C. attorney who specializes in class actions and complex litigation issues; and Brett Findler, founder of a non-recourse legal and medical funding company designed to help trial lawyers and their injured clients. Each speaker provided real-world perspectives concerning the three determinations the Task Force was charged with addressing.

The Task Force also heard from Professor Donald Kochan, Executive Director of the Law & Economics Center at George Mason University, who provided insights into the third-party litigation financing market and judicial and legislative responses. Dr. Marcus Osborn offered insurance perspective, informing the Task Force of the issues, concerns, and efforts that framed the recent Arizona legislative House Bill HB 2638 (relating to litigation financing and consumer protection). Aaron Nash, Director of the Certification and Licensing Division, and Marquita Brazil, Manager of the Alternative Business Structures at the Administrative Office of the Courts, informed the Task Force of the process, procedure, and information requested when applying for an ABS license.

Additionally, the Task Force heard from Juliet Oliver, General Counsel of the Solicitors Regulation Authority ("SRA"); the SRA governs, among other things, the ABSs licensure program in England and Wales. Ms. Oliver informed the Task Force about the SRA's experience with third-party litigation funding in the context of their ABSs program.

Finally, the Task Force heard from Professor Maya Steinitz of the Boston University School of Law. Professor Steinitz is an expert in the field of law firm financing and author of a University of California Davis Law Review article titled, *Follow the Money? A Proposed Approach for Disclosure of Litigation Financing Agreements*. Professor Steinitz's article was provided to the Task Force as a resource material.

C. Summary of Recommendations

1. The Task Force found no issues with third-party litigation funding in Arizona's ABSs. Concerns about third-party funding are not unique to ABSs. Unlike traditional law firms, ABSs have rigorous application standards, disclosure requirements, and annual renewals.

2. Most of the Task Force members acknowledge the importance of third-party litigation funding in providing access to justice and advised against undue constraints on such funding or its providers. They believe existing ethics rules can address most issues related to third-party funding. However, the Task Force identified two major concerns that require additional consideration: potential third-party control over litigation strategy and decisions and the risk of funders accessing trade secrets or compromising competitors' economic interests.

3. The Task Force recommends limited initial disclosure in cases involving third-party funding. This approach serves two key purposes: alerting the court to protect client interests, especially in class-action cases, and notifying opposing parties of potential conflicts. Essential disclosures include the existence of third-party funding and the funder's identity. If concerns arise, the court or opposing parties can request further information or safeguards.

4. The Task Force concluded that third-party litigation funding agreements should not be subject to initial disclosure. While some argue these agreements should be disclosed like insurance contracts, the Task Force believes they are different. Insurance contracts are often standard and relevant to settlement negotiations, whereas third-party litigation funding agreements involve internal business practices and litigation strategy, potentially protected by attorney work product privilege. However, courts can review these agreements in camera or disclose them to opposing parties if there is good cause.

5. The Task Force acknowledges the importance of collecting relevant and readily available data regarding third-party funding, balanced against the onus and resources required to do so, recommends adding a question to the Civil Cover Sheet inquiring whether the case involves third-party litigation funding.

6. Lastly, judicial training and education should be conducted to instruct the civil bench on concerns of third-party litigation funding, issues that may arise in discovery, and best practices for implementing and limiting scope of disclosure.

D. How Other Jurisdictions Have Treated Third-Party Litigation Funding

The Task Force reviewed information on how other jurisdictions have taken various approaches to regulating third-party litigation funding agreements. These approaches include banning third-party litigation funding; regulating through statutes, common law, and ethics opinions; and regulating via local rules or standing orders of the court.

Only Kentucky, Georgia, and Montana have explicitly banned third-party litigation funding by statute. Specifically, Kentucky and Georgia prohibit third-party litigation funding by any person,[1] and Montana prohibits third-party litigation funding by attorneys.[2] Additionally, Alabama courts have declared such agreements void on public policy or usury grounds.[3]

Several states regulate, but do not ban, third-party litigation funding, focusing on disclosure and consumer protection. For instance, Wisconsin requires disclosure of third-party litigation funding agreements in court, even without discovery.[4] States like Indiana, Illinois, Arkansas, Maine, and West Virginia, and others have enacted laws mandating specific disclosures or regulating interest rates. New York uses champerty statutes to regulate but construes them narrowly. Missouri and Texas are considering legislation to regulate these agreements.[5] Some states, such as Alaska, Arkansas, California, Florida, New Jersey, Texas, and Washington, regulate third-party litigation funding through court rulings or ethics opinions. Colorado, Maryland, and Michigan courts have treated these agreements as loans subject to consumer credit laws.[6]

In 2024, state legislatures around the country looked at bills aimed at addressing third-party litigation funding in a variety of ways. Alabama, Arizona, California, Florida, Georgia, Iowa, Kansas, Minnesota, Mississippi, Missouri, New Jersey, New York, Ohio, Oklahoma, and Rhode Island all saw proposed legislation introduced to regulate third-party litigation funding in some way, but the bills were not ultimately adopted. On the other hand, Illinois, Indiana, Louisiana, Montana, and West Virginia all passed legislation that regulated third-party litigation funding to some extent.

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[1] Ky. Rev. Stat. Ann. § 372.060 (West 1942); Ga. Code Ann.§ 13-8-2 (West 2016); *Sapp v. Davids*, 168 S.E. 62 (Ga. 1933).

[2] Mont. Code. Ann. § 37-61-408 (West 2009).

[3] *Wilson v. Harris,* 688 So.2d 265 (Ala. Civ. App. 1996).

[4] Wis. Stat. Ann. § 804.01 (West. 2018).

[5] *See Report to the Chief Justice and the Presiding Judges of the State of Delaware from the Committee to Study Transparency in Third-Party Litigation Funding* at 7, https://courts.delaware.gov/forms/download.aspx?id=265958 (last visited Oct 1, 2024).

[6] *Id.* at 7.

Additionally, the Task Force was informed that Congress is currently considering legislation to address certain aspects of third-party litigation funding. The first is Senate Bill S.2805[7] and its companion bill H.R. 5488,[8] cited as the "Protecting Our Courts from Foreign Manipulation Act of 2023," which is intended to increase oversight of third-party funding by foreign persons or states. The second, in discussion draft form, is the "Litigation Transparency Act of 2024," which was released on July 11 by Rep. Darrell Issa (R-CA), Chairman of the U.S. House Committee on the Judiciary's Subcommittee on Court, Intellectual Property, and the Internet. The bill would require the disclosure of any third-party that has a right to receive any payment contingent on the outcome of the civil action and require the agreement to be produced to the court and the named parties.[9]

Courts such as the U.S. District Court for the District of Northern California and the U.S. District Court for the District of Delaware, have standing orders requiring disclosure of financial interests in litigation.[10] The U.S. District Court for the District of New Jersey has amended its local rules to require disclosure of third-party litigation funding agreements.[11]

Not all courts are tightening regulations on litigation financing, however. In *Trustees of Purdue University v. STMicroelectronics N.V.*, the defendants moved to compel disclosure of conversations between the plaintiff and its third-party litigation funder.[12] The U.S. District Court for the Western District of Texas reviewed these documents in camera and denied the motion, finding them to be not only irrelevant but privileged.[13]

Concordantly, in the case of *Lower48 IP LLC v. Shopify, Inc.*, defense sought an order compelling the plaintiffs to disclose all third-party interests in the action, alleging that third-party litigation funders were providing financial support.[14] The court denied the motion citing that

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[7] *S.2805-Protecting Our Courts from Foreign Manipulation Act of 2023,* Congress, https://www.congress.gov/bill/118th-congress/senate-bill/2805?q=%7B%22search%22%3A%22 litigation+funding%22%7D&s=1&r=10 (last visited Oct. 1, 2024).

[8] *H.R.5488-Protecting Our Courts from Foreign Manipulation Act of 2023*, Congress, https://www.congress.gov/bill/118th-congress/house-bill/5488?q=%7B%22search%22%3A%22 litigation+funding%22%7D&s=1&r=11 (last visited Oct. 1, 2024).

[9] *Issa Introduces Discussion Draft of Legislation Reforming Third-Party Financed Civil Litigation*, Darrell Issa, https://issa.house.gov/media/press-releases/issa-introduces-discussion-draft-legislation-reforming-third-party-financed (last visited Oct. 1, 2024).

[10] *Supra.* at 9–10.

[11] D. N.J. Civ. R. 7.1.1.

[12] *Trustees of Purdue Univ. v. STMicroelectronics N.V.*, No. 6:21-CV-00727-ADA, 2023 WL 11917023, at *1 (W.D. Tex. Jan. 18, 2023).

[13] *Id.* at *2.

[14] *Lower48 IP LLC v. Shopify, Inc.*, No. 6:22-CV-00997, 2023 WL 11893431, at *1 (W.D. Tex. Nov. 2, 2023).

"precedent in the Western District of Texas has consistently denied motions to compel production of information related to third-party litigation funding."[15]

The Advisory Committee on Civil Rules to the Judicial Conference of the United States has examined third-party litigation financing and the impact it has on federal courts.[16] So far, they have declined to propose any immediate action but continue to monitor and retain the topic on the Committee's agenda.[17]

II. Third-Party Funding Overview

In traditional third-party litigation funding, a litigant, business, or law firm would draw on a line of credit and use the capital to pay for the lawsuit. Insurance for defense costs is another form of third-party litigation funding. While third-party litigation funding is a broad term that can refer to a wide range of different practices, for the purposes of this report, the following definition applies:

> A non-recourse loan for the purposes of pursuing or defending a civil action, administrative proceeding, claim, or cause of action (which includes legal filings, legal document preparation and drafting, appeals, creation of a litigation strategy, testimony, discovery, retention of experts, and related litigation expenses), or a portfolio of cases, where the funder secures a financial interest in any potential recovery, with the following exceptions:
>
> 1. It does not include financing, loans or any other type of funding agreement or arrangement to pay expenses that require repayment of the loan or funding no matter the outcome of the litigation.
>
> 2. It also does not include financing, funding, advances or loans for personal needs or medical treatment of a party but does include expenses for exams or diagnostic testing that is solely used for pursuing a claim.
>
> 3. It also does not include funding received from an entity or insurer with a preexisting contractual obligation to indemnify or defend a party to the civil action, administrative proceeding, claim, or cause of action or a health insurer which has paid, or is obligated to pay, any sums for health care for an injured person under the terms of any health insurance plan or agreement.

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[15] *Id.* at *3.

[16] Advisory Committee on Civil Rules 371–99 (Oct. 5, 2021), https://www.uscourts.gov/sites/default/files/2021-10-05_civil_rules_agenda_book_final_1.pdf.

[17] *Id.* at 371.

> Non-recourse means if the plaintiff loses the case, the funder receives nothing. This closely resembles a contingency fee arrangement where the law firm acts as both attorney and funder and can only recover from the proceeds of the case.

The types of third-party litigation funding this Task Force was informed about consisted of a non-recourse investment to the lawyer, client, or both, with the repayment coming from the litigation recovery. Under any of these arrangements, the return to the funder can be calculated as a percentage of the recovery or based on a return of the principal advanced plus a rate of interest.

A. Lawyer-Funder Arrangement

In a lawyer-funder arrangement, the funder invests directly with the lawyer or law firm. The funder provides capital for litigation expenses and some or all the attorney's fees in exchange for a share of the recovery. A law firm that pursues cases on a contingency basis may secure funding by its share of the recovery. Law firms utilize third-party funding to litigate cases that would normally be cost-prohibitive due to litigation costs, such as expert witnesses. Even when law firms may have the resources to litigate high-value cases, third-party litigation funding allows the law firm to secure resources for lower-value cases, often leading to better results.

B. Client-Funder Arrangement

In a typical client-funder arrangement, the funder provides capital to the client. The client agrees to compensate the funder from the recovery of the lawsuit. Some client-funder litigation funding involves amounts paid to fund the living and medical expenses of a personal injury plaintiff and not necessarily to support the funding of the lawsuit itself.

More recently, there has been an emphasis on funders investing in expensive lawsuits that have a possibility of large awards. These clients are often well-funded, sophisticated, and repeat litigants, such as a business. In this circumstance, the third-party litigation funding is being used to fund the lawsuit directly as opposed to providing ongoing living expenses.

C. Portfolio Funding

A recent development is portfolio funding. This funding can be provided to clients involved in multiple actions, or to lawyers handling multiple actions involving different clients. The funding is structured around multiple claims in the form of cross-collateralization, meaning the funder's return is dependent upon the overall net financial performance of the portfolio as opposed to the outcome of each particular claim.

III. Arizona's Alternative Business Structures (ABSs)

The Task Force was charged with examining third-party litigation funding within the context of ABSs. Under ACJA § 7-209, an ABS "is a business entity that includes nonlawyers who have an economic interest or decision-making authority in the firm and provides legal services in accord with Supreme Court Rules 31 and 31.1(c)."[18]

To become a licensed ABS, a business entity must apply on approved forms and file them with the Certification and Licensing Division staff ("Division Staff").[19] The application requires the business entity's organizational information, including background information on the designated principal, compliance lawyer, and all authorized persons or entities with decision-making authority or an economic interest of ten percent or more. The applicants must also provide a brief description of the business structure and services, legal and non-legal, as well as the objectives and regulatory alignment. Of note, is question 7 of Section 8 of the application titled "BUSINESS INFORMATION." Here, the applicant is asked if they use or intend to use any outside or external sources of finance or investment. This includes information such as the type of financing, name of the provider, amount of financing, and interest rate. We are advised that the Committee will consider additional and more specific disclosures in both the initial and application process.

Division Staff review the applications and supporting documents for completeness and investigate any discrepancies. This includes, for example, allegations of acts of misconduct, professional license discipline and investigations, business investigations, criminal convictions, and any civil litigation in which the applicant or authorized person is listed as a defendant, or violations of statutes, court rules, or applicable sections of the ACJA by applicants or authorized persons. Division Staff then report their findings to the ABS Committee.

The ABS Committee will review the application, supporting documents, the report, and recommendation of the division staff, and hold a public meeting where the committee members may ask questions of the applicants to determine possible action regarding the approval or disapproval of the recommendation of a grant of licensure to the Arizona Supreme Court.

Once approved by the Arizona Supreme Court, ABSs have two systems of oversight. First, the State Bar can receive complaints, investigate allegations, and discipline both the ABS law firm and compliance lawyer. Compliance lawyers are prohibited from having any disciplinary history for a period of ten years. Secondly, each ABS must reapply for licensure renewal. Misconduct by the ABS can result in denial of the renewal.

Any changes in an ABS's authorized persons, designated principal, or compliance lawyer must be sent to the division for review, along with background information. A proposed merger or

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[18] Ariz. Code. Jud. Admin § 7-209(A), https://www.azcourts.gov/AZ-Supreme-Court/Code-of-Judicial-Administration.

[19] *See generally How to Apply for ABS Licensure*, Arizona Supreme Court, https://www.azcourts.gov/cld/Alternative-Business-Structure/How-to-Apply (last visited Oct. 1, 2024).

acquisition of an ABS law firm must be approved by the division and Committee and requires a full application, disclosing all of the background information of all authorized persons.

The Task Force heard from a variety of speakers that third-party litigation funding occurs within and outside of the ABS program.

IV. Regulation Proposals for Third-Party Litigation Funding

Many jurisdictions, both state and federal, have either enacted or attempted to enact regulations on third-party litigation funding. In Arizona there were two such proposals; one legislative, the other judicial.

A. Arizona Legislative House Bill HB 2638

During the 2024 Legislative Session, House Bill HB 2638 was introduced but did not make it out of the House. According to its stakeholders, the bill was intended to regulate third-party litigation funding by improving transparency through disclosure, consumer protections, regulation of financial companies, and preventing foreign investors from using third-party litigation to harass businesses.

The bill contained certain prohibitions for consumer protection and financial regulation as it aimed to:

- Prohibit a litigation financier from directing or making any decisions with respect to the litigation.
- Prohibit the financier from receiving a larger share of the proceeds than the litigant.
- Prohibit paying or offering to pay a commission, referral fee or other consideration for referring a person to the litigation financier.
- Prohibit assigning, including securitizing, a financing agreement.
- Prohibit a financier from being assigned rights to an action that is subject to an agreement to which that financier is a party.

Disclosure requirements included:

- Legal counsel who enters into a funding agreement must deliver a copy to all persons that legal counsel is representing in the action within 30 days of being retained or entering into the agreement.
- Requires a party to an action, without awaiting a discovery request and within 30 days after commencement of the action, to provide a copy of the funding agreement to all parties in an action, the court, any insurer, and all members and approved legal counsel in a class action or multidistrict litigation action.

- Requires a party to an action, without awaiting a discovery request and within 30 days after commencement of the action, to provide the name, address and citizenship or country of incorporation or registration of any foreign person, foreign principal or sovereign wealth fund to the U.S. Department of State and the U.S. Attorney General in addition to all parties in an action, the court, any insurer, and all members and approved legal counsel in a class action or multidistrict litigation action.

Additionally, the proposed legislation required the court in any class action or multijurisdictional lawsuit, to consider the existence of third-party litigation funding and any related conflicts of interest when approving or appointing counsel to leadership positions. The bill also deemed an agreement entered into in violation of these requirements to be void and any financier who violated any of the requirements to have committed an unlawful practice under A.R.S. § 44-1522. Stakeholders informed the Task Force that they intend to reintroduce the bill in the next legislative session.

B. Petition to Amend ACJA § 7-209

In February 2024, a proposed amendment to ACJA § 7-209 was provided to the Administrative Office of the Courts by the Greater Phoenix Chamber and on behalf of various business community stakeholders.[20] The proposed amendments would add a new definition to Subsection A, titled "Definitions"; and additional requirements to Subsection G, titled "Role and Responsibilities of Licensed Alternative Business Structures and Compliance."

The amendment to Subsection A would define "third-party funder" and "material litigation or settlement decisions" to establish the nature of the activities to which a funder may engage in a particular litigation or other legal matter, as well as the scope of the legal decision-making process the funder may be involved in.

The amendment to Subsection G would establish disclosure requirements for third-party funders. The ABS would be required to provide the following in their application:

- Names and addresses of any third-party funder participating in the ABS as well as the name of every owner, member, and partner, proceeding up the chain of ownership until every individual and corporation with direct or indirect interest in the party has been identified.
- The nature of the financial interest or non-monetary benefit in the ABS.

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[20] AZ Sup Ct Petition Rule 7-209 1-26-2024 Biz Cmty.pdf.

- Whether the third-party funder has authority to control or make material litigation or settlement decisions in any action undertaken by the ABS involving the practice of law.
- The terms of any agreements with a third-party funder.

Additionally, the proposed rule would create an ongoing obligation for an ABS, even if already licensed, to provide any funding contract or agreement under which a third-party funder has received or has a right to receive compensation or proceeds from a legal claim to all parties in litigation the ABS is involved in, including any insurer if prior to litigation, without awaiting a discovery request. The proposed amendment would make the existence of such funding, and all participants in such funding permissible subjects of discovery in all civil cases.

V. Benefits and Concerns of Litigation Financing

The Task Force heard from a multitude of speakers on several benefits, considerations, and concerns regarding third-party litigation funding. Although the Task Force received numerous insights regarding third-party litigation funding, concrete real-world occurrences were often lacking. But some documented illustrations of the concerns were raised.

A. Meritless Lawsuits

One concern is that third-party litigation funding may result in the filing of cases that otherwise would not be filed. If these cases lack merit, then the funding would create a burden on the court system. However, if the claim is legitimate, proponents of funding argue it is providing access to justice for those who would otherwise be unable to afford it. The Task Force also heard it is possible that third-party litigation funding could be used to generate mass tort litigation where the purpose is to push for a settlement prior to trial instead of achieving justice for clients.

The Task Force was informed by the third-party funders that they conduct their own analysis of the strengths and weaknesses of the case, as well as the experience of the lawyer, and are unlikely to provide funding to a meritless case. However, the Task Force also heard from a professor that in the securitization of litigation funding, full due diligence will not work. Furthermore, attorneys are governed by the Arizona Rules of Professional Conduct regarding such actions. Namely, Ethical Rule ("E.R.") 3.1, which states in part, "[a] lawyer shall not bring or defend a proceeding, or assert or controvert an issue therein, unless there is a good faith basis in law and fact for doing so that is not frivolous . . . ." The reliance on this longstanding ethical rule is one of the reasons that some argue no further regulatory safeguards are needed to ensure lawsuits without merit would not be filed.

B. Litigation Control

Instances of attempted exerted control appear confined to large, commercial actions and remain rare in individual plaintiff actions. Funding contracts typically contain provisions that explicitly prohibit control over settlement or litigation decisions by the funder. Also, the Arizona Rules of Professional Conduct serve to protect the lawyer and client from undue influence. For example, E.R. 1.6 governs confidentiality and can be used to safeguard communications from funders. Additionally, E.R. 1.7 and E.R. 1.8 address conflicts of interest that may impair the lawyer's ability to adequately and competently represent a client.

For purposes of identifying matters that should be protected against funder control, the Task Force finds the following definition helpful:

> "Material litigation or settlement decisions" include, but are not limited to, decisions whether to:
>
> 1. accept a settlement offer;
> 2. enter into settlement negotiations;
> 3. accept, refuse, or make a counteroffer to a settlement offer;
> 4. file a motion to dismiss, motion for summary judgment, other significant motions, or any other paper in a particular case, or what position to argue in any such pleading;
> 5. choose witnesses to depose, offer for deposition, or present at a trial, settlement conference, mediation, arbitration, or any other judicial or quasi-judicial proceeding;
> 6. engage, retain, or dismiss legal counsel or any other consultant to provide legal advice, strategic advice, or handle any aspect of any case or matter.

This includes a third-party funder's attempted influence over a lawyer's decision in a manner which is not in the best interest of the client.

C. Consumer Protection

Another area of concern is that third-party litigation funders promote a model, especially in mass tort cases, that is driven by profit-over-client representation. This may include referral fees, securitizing litigation funding, and agreements where the funder receives a larger portion of the judgment than the litigant. It is argued that third-party litigation funding involves a disparity in sophistication and bargaining power, and raises issues typically associated with consumer lending, particularly high-interest consumer loan products. To some extent, such issues already exist in class-action lawsuits.

Where these concerns have been an issue, primarily in mass torts, the court typically approves the distribution of funds. The court's involvement can include appointing a neutral party such as a retired judge to oversee the allocation of settlements distributions and applying standards or criteria to ensure distribution plan fairness. Additional screening mechanisms can be implemented at this stage to guard against egregious funding terms. In the individual context of catastrophically injured clients, similar probate approval process must be undergone to obtain approval of all distributions.

Finally, while conceivable that individual plaintiff cases may be sought for the benefit of an individual, third-party funder, there are a lack of reported instances. Courts already possess the ability to call for additional information or disclosure which may unfairly weigh against the interest of a client upon a showing of good cause. Law firms engaging in such tactics are unlikely to escape judicial scrutiny for very long.

D. Conflicts of Interest

The Task Force heard concerns regarding conflicts of interest that can manifest in different ways. When third-party litigation funders invest in a portfolio of cases, they may end up funding a litigant that is adversarial to another client. This may create a situation where a lawyer must choose between his obligation to a client and the availability to access future funding. There may be a witness or judge who has a financial investment with the funder which may change the witness's incentive to testify truthfully or call into question the judge's impartiality. A rival business may fund litigation against a competitor for the sole purpose of harassment or to obtain privileged information or trade secrets through the discovery process. Lawyers involved in cases with funding must navigate complex ethical rules regarding conflicts of interest, confidentiality, and client communication.

E. Foreign Investors

The Task Force heard concerns regarding the use of foreign monies being used in third-party litigation funding. The concerns that were raised were similar to those regarding conflicts of interest. A foreign adversary could fund frivolous lawsuits to overwhelm U.S. courts. Foreign governments or businesses could fund target lawsuits to weaken businesses or industries. Foreign funders may also try to obtain confidential information through the discovery process or use court filings to push theories as part of a coordinated disinformation campaign they are already waging through social media. A foreign citizen could invest with a third-party litigation funder to get around economic sanctions imposed on them by the United States. The Task Force received information regarding litigation insurance and the presence of foreign funds in reinsurance, so, theoretically, some of the same concerns already exist.

Once again, the concern over foreign influence is mainly limited to the larger commercial intellectual property, and mass tort cases. Even so, the extent of influence remains highly speculative. Such foreign influence remains unreported on the individual plaintiff level. Additionally, the market serves as a limiting constraint on funders pursuing "frivolous" lawsuits on an individual basis, even those with foreign ties.

F. Disclosure Requirements

Perhaps the most discussed consideration regarding third-party litigation funding was what, if any, level of disclosure third-party litigation funding should have. According to proponents of disclosure, full disclosure of not only the existence of funding but the agreements themselves are vital to addressing the concerns the Task Force was informed about. They argue that disclosure is necessary to prevent finance providers from hiding their influence over litigation decisions or disguising their true motive for funding the case. Proponents also argue that disclosure is the only method for the court and the parties to identify any potential conflict-of-interest issues.

Opponents argue that disclosure is simply about gaining insight into the plaintiff's case and could reveal the terms of the funding or resources available to the party, giving defendants leverage in settlement negotiations. Opponents also argue that funding agreements may constitute confidential attorney work product.

The primary concern of opponents of disclosure is privacy; they argue that businesses and individuals expect their financial details to remain private. Proponents, however, compare the disclosure of third-party litigation funding to the disclosure of insurance coverage. The rationale for disclosing insurance information is to enhance judicial efficiency. If a defendant lacks liability insurance, there may be no funds to cover any potential liabilities. In such cases, it would be inefficient for the court and the involved parties to proceed with litigation, knowing that there would be no recovery at the end. Another critical concern for plaintiffs is the potential misuse of funding information by defendants. Knowledge of a plaintiff's funding could lead to a "war of attrition," where defendants deliberately prolong litigation and overwhelm plaintiffs with motions, thereby depleting their financial resources.

On the other hand, defendants have legitimate due process concerns. They need to understand who the actual party in interest is, especially if the plaintiff is merely a shell entity or lacks control over litigation decisions. This knowledge is crucial for ensuring fairness in the legal process. Defendants are also interested in a correct proportionality analysis regarding disclosure, which is closely tied to the plaintiff's resources. Additionally, practical considerations arise, such as ensuring that the appropriate decision-makers are present during settlement discussions.

The court has a vested interest in maintaining the integrity of the judicial process. Judge Connolly of the U.S. District Court for the District of Delaware expressed concerns about the integrity of the process being compromised when the real parties in interest are absent from the courtroom.[21] Transparency is another vital issue for the judiciary and the public. There is a need for public awareness and debate on the legitimacy of certain uses of the court system, such as "revenge funding," where funders provide capital to litigants for personal vendettas against defendants. Unfortunately, the lack of available data on third-party litigation funding complicates the ability to provide insights and monitor potential issues. Most disputes over funding agreements are resolved privately, away from public scrutiny through arbitration. Regulators, therefore, lack the necessary data to enforce effective regulations. Another judicial concern is that third-party litigation funding can prolong the duration of cases, thereby affecting judicial economy.

Finally, funders themselves have significant interests at stake. Their agreements and terms are proprietary financial products, with details such as the rate of return being sensitive and competitively valuable. This report notes, however, that insurance agreements, which are generally disclosed, may also contain financial and competitively valuable information.

VI. Specific Examples

The concerns with third-party litigation funding described above are not merely hypothetical. The Task Force was provided with cases where courts were confronted with and addressed some of these issues.

Earlier this year, the U.S. District Court for the Eastern District of Texas heard arguments from a defendant to compel the plaintiffs to reveal what the defendant described as identification of and communications with investors in view of theft of [the defendant's] privileged information, involving two attorneys involved with the plaintiffs who were previously employed by the defendant.[22] The defendant sought discovery of litigation funding documents to support its claim that its opponents used the disclosure process to access confidential information to craft its lawsuit.

In the U.S. District Court for the District of Minnesota, Buford Capital, a third-party litigation funder, was accused by its client, Sysco Corp., of blocking reasonable settlement offers in its antitrust cases.[23] Buford then attempted to replace Sysco as the main party, but the court rejected the funder's attempt to take Sysco's place.

In another case, *Nimitz Technologies, LLC v CNET Media, Inc.*, after ordering the parties to certify their compliance with his standing order to disclose the existence of third-party litigation funding and the identities of those involved, Chief Judge Connolly of the District of Delaware observed that several cases before him appeared related despite having been brought by seemingly

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[21] *Nimitz Techs. LLC v. CNET Media, Inc.*, No. CV 21-1247-CFC, 2023 WL 8187441, at *26 (D. Del. Nov. 27, 2023).

[22] *Stanton Techiya LLC, et al. v. Samsung Electronics CO. Ltd., et al.*, E.D. Tex., 2:21-cv-00413

[23] *In re Pork Antitrust Litig.*, MDL 22-3031 (JRT/JFD) (D. Minn. Jun. 3, 2024) and *In re Cattle & Beef Antitrust Litig.*, 22-3031 (JRT/JFD) (D. Minn. Aug. 17, 2023).

different plaintiffs and sua sponte ordered a hearing. Chief Judge Connolly discerned that the plaintiffs in these cases were shell companies and had little involvement in the actual litigation. Chief Judge Connolly ordered all plaintiffs to disclose information related to third-party interests, including engagement letters, assets and bank account information, as well as correspondence between plaintiff's attorneys and the third-party funder.[24] Plaintiffs filed a petition for a writ of mandamus for a reversal of the order but were denied.

Examples of problems with third-party litigation funding principally arise in large commercial cases and class-action lawsuits. Small firms often use third-party litigation funding to cover high expenses, and the Task Force did not hear issues arising in that context.

Likewise, *Burkhart v. Genworth Financial, Inc.*, is notable as it is the fourth decision from a Delaware state court finding litigation finance agreements discoverable:

> [The defendants] argue that the presence of litigation funders creates the potential for conflicts of interest that may incentivize counsel to prioritize the interests of the Funders over those of the class. And the potential for such conflicts makes the Funders' identity and the character of its interest in the litigation relevant and necessary to test whether the Plaintiffs are truly independent from the Funders' direction and control.[25]

The court stated, "[a]s it relates to these considerations, I believe there may be legitimate concerns that counsel could face a conflict of interest. There are many instances where a funder's interest might diverge from those of a claim holder."[26]

Although the plaintiffs also argued work product protection, the court disagreed and compelled production.[27]

VII. Options for Disclosure

The interests discussed above can be directly linked to specific factors in any litigation or arbitration. This is crucial because judges should not have to evaluate the abstract concept of disclosure. For consistency, courts should have clear, consistent rules governing third-party litigation funding.

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[24] *Nimitz*, *supra*, n. 30.

[25] *Burkhart v. Genworth Financial, Inc.*, C.A. No. 2018-0691-NAC, 2024 WL 3888109, at *3 (Del. Ch. Aug. 21, 2024) (cleaned up).

[26] *Id.* at *4.

[27] *Id.* at *5–7.

However, many on the Task Force view that courts should have flexibility to employ various methods such as in camera or ex parte submissions, redactions, sealing parts or the entire funding agreement, or requesting attorneys to certify representations about the contents of an undisclosed agreement. The following is a progression of disclosure approaches courts might follow to address the interests and potential conflicts that arise during litigation.

A. Existence of a Funding Relationship

The minimal disclosure approach involves simply acknowledging the existence of a funding arrangement, without providing any details. This allows the court and parties to remain vigilant for any potential adverse effects of the funding on the case. Such a disclosure should not impose a significant burden.

B. Control Over the Litigation

A further level of disclosure would require parties to indicate whether the third-party litigation funder has any control over the litigation process. This addresses the primary concern regarding third-party litigation funding. If a funder does have control rights or if there is ambiguity, a redacted version of the funding agreement could be provided, or the court could review the agreement in camera.

C. Identity of the Third-Party Litigation Funders

Requiring disclosure of identity of the funding entity and its investors enables the court and opposing parties to check for conflicts of interest. Doing so also allows the court to identify if the third-party funder has a history of inappropriate interference in litigation. This level of disclosure should be manageable.

D. The Funding Agreement

A greater degree of disclosure would involve producing the funding agreement itself. Many on the Task Force thought this could reveal sensitive information that might unfairly benefit the opposing party—such as the financial return structure, which might indicate the perceived risk level of the case. Opponents could use this information to make strategic decisions. It could also disclose the expected duration before the case's resolution. This level of disclosure would most likely be appropriate if there is a showing of substantial need after less intrusive levels have been explored.

E. Case Analysis

The most intrusive disclosure would involve producing the case analysis, which is generally protected by the work product doctrine. Mandating the disclosure of such material could disrupt the litigation process significantly and might reduce the availability of funding for valid claims.

VIII. Two Examples: The Order Regarding Third-Party Contingent Litigation Financing in *In re Nat'l Prescription Opiate Litigation* and The Standing Order regarding Third-Party Litigation Funding Arrangements in the U.S. District Court of Delaware

A. In re Nat'l Prescription Opiate Litigation

Judge Polster of the United States District Court for the Northern District of Ohio, presiding over a multidistrict litigation case ("MDL case"), applied a nuanced judicial approach that considered the specifics of the case, the funded parties, the procedural stance, their conflict-of-interest implications, and used tools such as ex parte submissions and attorney certifications.

Judge Polster broadly defined "third-party contingent litigation financing" as "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 an MDL case, whether by settlement, judgment, or otherwise."[28] He also clarified that this definition does not include "subrogation interests, such as the rights of medical insurers to recover from a successful personal-injury plaintiff."[29]

Furthermore, Judge Polster tailored a disclosure regime specific to the case. He stated, "absent extraordinary circumstances," discovery into third-party contingent litigation financing would not be permitted.[30] However, he required that any attorney involved in an MDL case with third-party litigation financing:

- Share a copy of this order with any lender or potential lender.
- Submit to the court ex parte, for in camera review:
    - A letter identifying and briefly describing the third-party contingent litigation financing.
    - Two sworn affirmations—one from counsel and one from the lender—confirming that the financing does not:
        1. Create any conflict of interest for counsel,
        2. Undermine counsel's obligation of vigorous advocacy,

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[28] *In re Nat'l Prescription Opiate Litig.*, No. 1:17-MD-2804, 2018 WL 2127807, at *1 (N.D. Ohio May 7, 2018).

[29] *Id.* at n.1.

[30] *Id.* at *1.

3. Affect counsel's independent professional judgment,

4. Give the lender any control over litigation strategy or settlement decisions, or

5. Affect party control of settlement.

By implementing these measures, Judge Polster ensured the protection of legal ethics amidst the complexities of third-party funding. He placed the responsibility for maintaining these standards, and the potential liability for failing to do so, on the attorneys, who are in the best position to identify and address any issues.

B. The Standing Order Regarding Third-Party Litigation Funding Arrangements in the U.S. District Court of Delaware

Similarly, on April 18, 2022, Chief Judge Colm F. Connolly of the United States District Court for the District of Delaware issued an order titled "Standing Order Regarding Third-Party Litigation Funding Arrangements" ("Standing Order") which applied to all cases assigned to Chief Judge Connolly where "a party has made arrangements to receive from a person or entity that is not a party (a 'Third Party Funder') funding for some or all of the party's attorney fees and/or expenses to litigation this action on a non-recourse basis in exchange for (1) a financial interest that is contingent upon the results of the litigation or (2) a non-monetary result that is not in the nature of a personal loan, bank loan, or insurance. [31]"

The Standing Order requires the party receiving such funding to disclose within 45 days of the order or 30 days of the filing of an initial pleading or transfer of the matter to the District, including the removal of a state action, the following:

- the identity and address of the funder;
- the place of formation for any funder that is a legal entity;
- the nature of the financial interest of the funder in the litigation; and
- whether approval by the funder is necessary for litigation or settlement decisions and, if the answer is yes, disclosure of the nature of the terms and conditions relating to that approval.

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[31] Standing order regarding third-party litigation funding. (2022). https://www.ded.uscourts.gov/sites/ded/files/Standing Order Regarding Third-Party Litigation Funding.pdf (last visited October 1, 2024)

The Standing Order also allows parties to seek additional disclosure of the terms of the party's arrangement with any litigation funder upon showing that:

- the Third-Party Funder has authority to make material litigation decisions or settlement decisions;
- the interests of any funded parties or the class (if appliable) are not being promoted or protected by the arrangement;
- conflicts of interest exist as a result of the arrangement; or
- other such good cause exists.

Judge Connolly issued this order upon concerns that litigation funders are forming entities and using them to bring suits based on patent claims. This Standing Order is intended to generate information on litigation funding so Judge Connolly can determine whether action needs to be taken.

IX. Recommendations

The Task Force was charged with determining whether ABSs should be authorized solely for the purpose of mass tort litigation, and whether ABSs should be required to provide substantial legal services in Arizona. Under the current system, ABSs may be authorized solely for the purpose of mass tort litigation. And they are not required to provide substantial legal services in Arizona. Other non-ABS law firms are not subject to requirements in either regard. Most of the Task Force members do not perceive any problems with the current approach.

Based on the extensive information the Task Force considered, it makes the following recommendations regarding third-party litigation funding:

1. The Task Force has not identified any issues with the current use of third-party litigation funding in Arizona's ABSs. The Task Force heard the concerns of third-party litigation funders, hedge funds, and others having ownership or an equity stake in an ABS but did not address this in the report. Any concerns with third-party litigation funding are not specific to ABSs. To the contrary, unlike traditional law firms, which may also receive third-party litigation funding, ABSs have extensive application and disclosure requirements and are subject to renewal. ABSs would additionally be subject to the same recommended disclosure rules as other law firms.

2. Some but not all on the Task Force believe that third-party litigation funding plays an important role in providing access to justice. The Task Force does not consider it wise or appropriate to unduly constrain such funding nor the entities that provide it, to the extent they are subject to the Supreme Court's jurisdiction. Some but not all of the Task Force concluded that some of the issues raised in connection with third-party litigation funding can be managed by existing ethics rules. However, the Task Force identified two serious

concerns that have surfaced in cases around the nation that require additional consideration: the potential for third-party control over litigation strategy and decisions and the potential for funders to obtain trade secrets or otherwise compromise competitors' economic interests through cases they fund.

3. After examining approaches employed in other states, most on the Task Force concluded that the best approach to deal with these concerns is limited initial disclosure in cases involving third-party funding. Such disclosure would play two important roles. First, it will put the court on notice that it will need to be diligent in insuring that the interests of clients, particularly in class-action cases, are protected and paramount. Second, it will provide notice to the opposing parties of possible conflicts concerning the parties. The two essential features of such disclosure are (1) the *fact* of third-party litigation funding and (2) the *identity* of the funder. If the disclosure raises red flags, either the court on its own motion, or the opposing parties for good cause shown, may seek additional information or safeguards.

4. Most on the Task Force concluded that third-party litigation funding agreements should not be subject to initial disclosure. Those who advocate for such disclosure observe that insurance agreements are typically subject to disclosure. Insurance contracts are often form contracts and can be relevant to settlement negotiations. Third-party litigation funding agreements, by contrast, inevitably involve internal business practices and possibly litigation strategy. They may be protected by the attorney work product privilege. But a court on its own motion may properly review such an agreement in camera or disclose it to opposing parties on good cause showing.

5. The Task Force acknowledges the importance of collecting relevant and readily available data regarding third-party funding, balanced against the onus and resources required to do so, recommends adding a question to the Civil Cover Sheet inquiring whether the case involves third-party litigation funding.

6. Lastly, judicial training and education should be conducted to instruct the civil bench on concerns of third-party litigation funding, issues that may arise in discovery, and best practices for implementing and limiting scope of disclosure.

Alternative Business Structures Task Force

Report and Recommendations

October ___, 2024

This publication can be provided in an alternate format or other assistance may be provided upon request by a qualified individual with a disability under the provisions of the Americans with Disabilities Act.

ZOMBIE LITIGATION: CLAIM AGGREGATION, LITIGANT AUTONOMY AND FUNDERS' INTERMEDDLING

INTRODUCTION

The main debate surrounding litigation funding in recent years has focused on the question of disclosure of funding agreements. While the issue is important, predominantly because of its effects on the course and outcome of individual cases, far more important are bigger, interrelated questions which have systemic effects on the civil justice system, the legal profession, and the nature of the attorney–client relationship. The rise of litigation funding has had profound effects. The subsequent rise of portfolio funding—which I here propose to view as a new form of undisclosed and unregulated claim aggregation—has broader-still effects including clients' potential, and at times actual, loss of autonomy over their cases as their lawyers become originators, brokers and/or managers of 'litigation assets.'

First, I identify and explain a new possible scenario which I call 'zombie litigation': litigation that a plaintiff no longer wishes to pursue or in some cases, does not wish to initiate but that nonetheless proceeds through the court system for the benefit of a funder that has control over the plaintiff's case. *Second*, I explain how funders' incentives to demand zombie litigation are increased by the financialization of litigation: the concomitant rise of portfolio funding and secondary trading in legal claims. *Third*, I identify and explain the numerous doctrines, rules of evidence, of procedure, and of professional responsibility that recognize and at times presuppose as axiomatic, the sanctity and centrality of a plaintiff's autonomy over their cases. *Fourth*, I map the harms said rules and doctrines seek to guard against and that would be unleashed if funder control over settlement decisions was normalized. These harms span unfairness at the level of individual cases, damage to the civil justice system as a public institution serving the public good, and erosion of the attorney–client relationship. The affected constituencies are plaintiffs, defendants, courts, and the public. *Fifth*, I also identify and systematize an emerging framework of addressing the risk of zombie litigation, and plaintiffs' loss of autonomy more generally, through managerial judging.

PART I – WHAT IS ZOMBIE LITIGATION?

To understand zombie litigation, I offer a hypothetical. The hypothetical is based, very generally and with some alterations, on a recent, high-profile case in which a Fortune 100 corporation was compelled by a funder to continue litigating after it had arrived at settlements that were acceptable to it and its defendants.[1] By abstracting away, simplifying and modifying from that specific dispute, I aim to both

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[1] *See Glaz LLC. v. Sysco Corp.*, Case No. 1:23-cv-02489-PPG (S.D.N.Y); *Sysco Corp. v. Glaz LLC*, No. 23-cv-1451 (N.D. Ill.); *In re: Pork Antitrust Litigation*, Case No. 18-cv-1776 (D. Minn.). I served as an expert witness produced by Sysco in its now-concluded arbitration against Burford Capital and petition to the Illinois court to vacate the arbitral award. The hypo is generally based on the public information regarding that case. Scholarly discussion of the case include Burford's expert's discussion in Bradley B. Wendel, *Controlling the Delegation of Control*, 2 Theoretical Inquiries in Law 25 (2023); Samir D. Parikh, *Opaque Capital and Mass-Tort Financing*, 133 Yale L. J. Forum 32 (2023); and Tom

avoid becoming entangled in its minutiae and idiosyncrasies; to convey that the reality of funders assuming control is a result of structural features which have emerged as litigation finance has evolved and not an outlier that can be dismissed as a one-off; and to illustrate the systemic effects such control might have.

A. How is zombie litigation created?

Big Corporation ("BigCorp") is a large distributor of widgets in the U.S., making it one of the biggest players in an industry that generates hundreds of billions of dollars a year in revenue. Big Litigation Financier ("BigFin") is one of the leading players in the no-longer-nascent litigation finance industry. It maintains several billion dollars of investments in a range of litigations in the U.S. and abroad. BigCorp brought several lawsuits against some of its suppliers for alleged antitrust violations throughout the American widget market. Its counsel, an AmLaw 100 firm ("BigLaw") approached BigCorp with a funding offer from BigFin. BigLaw had worked with BigFin a number of times in the past, and planned on doing so again in the future. At the time it approached BigCorp, in fact, BigLaw had several cases related to the widget industry also funded by BigFin. BigLaw has taken on the widget cases – both those of BigCorp and of other clients – on a contingency fee basis.

Before continuing with the hypo, it is worth pausing to review the different interests of each of the actors. BigCorp is seeking to recover damages it suffered as the result of the alleged anticompetitive behavior of its suppliers and to discourage such behavior in the future. But it also has ongoing business relationships with those suppliers which it plans on maintaining into the future. BigLaw is interested in the fees it will earn from BigCorp, the additional fees it will earn from the other widget cases it is handling, and its 'repeat play' business relationship with BigFin which is funding its current suite of widget cases and is likely to fund future cases as well. BigLaw also has an interest in maintaining a good relationship with BigCorp, of course, but the market for legal services has evolved away from the type of loyalty big firms use to enjoy from their corporate clients. There are also many potential large clients and few large funders. Hence, the potential for repeat play is stronger with BigFin than with BigCorp. For BigCorp's lead counsel in the widget matters ("BigPartner," a rainmaking partner at BigFirm), the relationship with BigFin could account for her entire book of business at any point in time or even for the remainder of her career since funders often refer clients to their counsel of choice. Finally, BigFin is interested in a maximum return on its investment. This means the largest possible monetary recovery not only from BigCorp's cases, but from all the widget cases across all plaintiffs that BigFin is financing. These include all of BigCorp's widget cases, and also other widget cases being handled by BigLaw and other law firms. BigFin, then, is engaged in *portfolio funding*, which has outpaced funding individual cases as the preferred model for large

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Baker, *What Litigation Funders Can Learn About Settlement Rights From the Law of Liability Insurance*, Theoretical Inquiries of Law, (2023). Sysco and Burford's lawyers in the real-world case, Boise Schiller, deny Sysco's allegations that they violated any rule of professional conduct.

commercial litigation funders.[2] We can already see that while it is certainly possible for all these interests to remain in alignment, there are also likely scenarios in which conflicts arise between and among the actors.[3]

BigCorp and BigFin entered into a litigation funding agreement which provided that BigFin would pay the legal fees for all of BigCorp's widget cases. In return, BigCorp agreed that BigFin would receive a portion of the recovery, if any. One of the recurring problems in litigation finance is aligning incentives. At this stage of the process, BigCorp has shifted the expenses of its claims off its own books, reduced its overall risk and the amount it may recover which, in turn, may lead it to be less invested in the prosecution of the case. This is a problem for BigFin, since maximal efforts by BigCorp's may be necessary to maximize its return. This issue is usually addressed through cooperation clauses and/or through staged funding, the provision of funding in stages which creates opportunity for funders to threaten discontinued funding if a plaintiff does not follow its advice/direction.[4] In our hypo, the agreement goes a step further, including language which BigFin believes afforded it a veto over settlement decisions.

If everyone's interests had remained aligned, the question of the interpretation of such a clause may never have come up, But those interests can easily become misaligned – if, for instance, as the litigation progresses and more information becomes available, BigCorp comes to believe its case is worth less than it originally thought. This could be due to procedural developments, emerging evidence, a change in the law, or any of a number of other factors. In such a situation, disputes could very well arise over the meaning of the type of intervention BigFin is allowed under the contract.

BigCorp received a settlement offer. Because it had come to believe its claims were worth much less than it originally thought and interested in resuming a normal relationship with its suppliers, BigCorp decided to accept the offer and settle its cases at a price significantly lower than was projected at the time BigFin decided to invest. BigCorp's decision to settle may also be affected by the fact that it has shifted some of its litigation risk onto BigFin. But recall that BigFin is a sophisticated funder well aware that litigation is a high risk/high reward asset class and that it is in the business of taking on risk that plaintiffs and contingency lawyers would otherwise carry. Indeed, that is a key reason it prefers to invest in portfolios, which provide diversification, rather than in single cases. Further, BigFin's business model is to require a very large percentage of any proceeds in all of its investments to compensate it for this and other risks that are inherent in litigations as assets.

BigCorp's decision to settle its cases affects the value of BigFin's investment in its entire widget portfolio of cases because the facts, the legal theories, and some procedural aspects of the cases across the portfolio overlap. Thus, the price at which BigCorp agrees to settle its cases may affect the entire

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[2] Julien Chaisse, Can Eken, *The Monetization of Investment Claims Promises and Pitfalls of Third-Party Funding in Investor-State Arbitration*, 44 Del. J. Corp. L. 113, 127 (2020).

[3] The literature on the conflicts of interests that are created once a funder is introduced into the attorney-client relationship even when a single case, not a portfolio, is involved is by now extensive. See, e.g., [citations]. Bar associations have also recognized, and cautioned against, such conflicts in the single case investment scenario and in the portfolio fundings scenario as well as with respect to situations where the funder- lawyers relationship is a one-time relationship as well as when it is a repeat play relationship. See infra [xx].

[4] [citations.]

'market' of widget cases, including all those in BigFin's portfolio. The same is true of BigLaw; having taken widget cases (those of BigCorp as well as of others) on a contingency fee basis it is both a lawyer and a financier. In the latter capacity, it is identically positioned as BigFin. Because of this, BigFin and BigLaw's interests no longer align with those of BigCorp, even though they were all aligned at the outset when they all agreed on the valuation of the case and sought to maximize a monetary settlement or judgment. The interests of the two financiers - BigLaw and BigFin - meanwhile, remain aligned. BigCorp's decision also jeopardized BigLaw's business relationship with BigFin. If BigFin lost big on a portfolio of widget cases sourced and brokered by BigLaw, then its prospects of future funding would become considerably dimmer. BigCorp has nothing more to gain from litigating - it is convinced the settlement offer is fair - and has much to gain from settlement: such as normalizing important business relationships and avoiding the continued drain of managers' and employees' time and energy. But for its investors, BigFin and BigLaw, BigCorp's cases are a commodity[5] and they affect the rest of their widget portfolio. BigCorp believed that once the interests of BigCorp, on the one hand, and BigPartner and BigFin, on the other hand diverged, BigPartner prioritized the interests of BigFin in ways that violated its professional responsibilities and so it fired BigLaw.

Litigation finance agreements routinely include arbitration clauses which means that disputes between funders and their clients, as well as funders' involvement in the litigations they invest in, remain out of sight for the court, the public and the defendants. The systemic effects of funders' intermeddling - whether influencing or outright controlling the litigation – are also not observable. In our hypo, BigFin sues BigCorp in international arbitration seeking to enjoin the settlement and force BigCorp to continue litigating the widget cases against its wishes. Note that this means that de facto, though not de jure, it would be enjoining the defendants to keep litigating and the courts to keep hearing the cases though neither defendants nor courts are aware of the international arbitration nor the existence or role of BigFin. The international tribunal ordered the injunction. What followed is what I call zombie litigation: litigation that all parties, plaintiff(s) and defendant(s), wish to settle but are compelled to continue litigating for the benefit of maximizing the return of the litigation funders.

B. Why might zombie litigation become an epidemic?

> "*If the mighty cedars caught fire, what shall the hyssops of the walls do?*"
>
> - Talmud, tractate Moed Ketan, 2

BigCorp may not garner much sympathy for losing control of its case to BigFin, given BigCorp's wealth, sophistication, and bargaining power. This, however, misses the broader implications of the hostile takeover of BigCorp's case. If a powerful corporation could neither retain its autonomy over its affairs nor command the loyalty of its counsel, other types of plaintiffs – individuals in individual cases and even more so in aggregate cases as well as smaller businesses do not stand a chance. In this subsection, I explain in brief why that is.

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[5] See Vicki Waye, Trading In Legal Claims: Law, Policy & Future Directions In Australia, UK & US (2008); M. Steinitz, *The Litigation Finance Contract*, 54 Wm. & Mary L. Rev. 455, 484 (2012).

At the risk of stating the obvious, commercial litigation funder's sole purpose, like that of other commercial enterprises, is to maximize the profits of its shareholders. Such entities are neither nonprofits nor benefit corporations. Any positive social externalities, such as increased access to justice and enhanced efficiencies for law firms, are a side-effect of profit maximization. Further, as is logical, litigation financiers are finance firms and so look to what firms in other parts of the financial industry have done. They do not seek to reinvent the wheel. Rather, they take existing, tried and true deal structures and modalities, and adapt them to the particular asset they are dealing with (lawsuits), the sector they serve (legal industry) and the regulatory environment (no regulation). A few things follow: as is true for other types of finance, influence and control facilitates profit maximization; economies of scale and diversification enhance efficiencies; and shifting risk is valuable. Litigation financiers thus have structural incentives to maximize all of these. Some consequent trends and prospects are explored in this subsection.

1. *Control over individually funded cases*.

Exerting control over financed cases is unlawful—"a lawyer should counsel a client to refuse any funding agreement that allows a funder to take control of a settlement, which would be seen as against public policy in every state, or withdraw from representation if the client persists in granting the funder control."[6] It also creates exposure for financiers—e.g., of lawsuits, getting dragged into discovery, reputational harm, and regulatory attention. This leads some funders to adopt a passive approach. Others straddle a line of exerting influence short of control. And others obtain control through one or more means. While funders generally avoid explicit control provisions in funding contracts, and often include provisions disclaiming control, what appears to be commonplace is *indirect* control—economic control rather than control through contractual agreement. Some funders appear to be exercising indirect control through a combination of control over the selection and replacement of lawyers; economic influence over or control of lawyers and law firms; and the ability to exit the funding arrangement mid-litigation which leads to a 'hold up' problem in funding agreements - funders' disproportionate bargaining power due to their ability to cease funding.

2. *Control of aggregate litigation.*

Aggregate litigation—mass and class actions—appear to be the fastest growing 'asset classes' for litigation funders.[7] Plaintiffs in such cases are, notoriously, often passive. Plaintiffs may be unable to control their cases because the cases are too small for it to be rational for them to invest the time. In the case of class actions, plaintiffs may not even be aware that they are plaintiffs. Even when plaintiffs' stake is large, plaintiffs in aggregate litigation often lack the bargaining power to steer their

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[6] Sebok, supra xx.

[7] [citation].

lawyers. One of the most common criticisms of aggregate litigation—class, mass, and derivative actions—is that contingency fee lawyers, not plaintiffs, drive and control such cases.[8]

Litigation funders have all the same incentives that contingency fee lawyers do and the same factors that disempower plaintiffs vis-à-vis their lawyers apply vis-à-vis the funders as well. Additionally, funded plaintiffs' lesser power is compounded by several factors. Plaintiffs may not even be aware that their cases are being funded.[9] Even when they are, they are even less likely to understand complex financial agreements than they are to understand lawyers' retention agreements.[10] The lawyers' conflicts with their clients are heightened because their loyalty is split between their clients—often a one-shot relationship—and their funders—often a repeat-play relationship.[11] Lawyers have fiduciary duties and other professional responsibilities towards their clients as well as towards the courts, and society writ large as 'officers of the court.'[12] Funders have no parallel obligations. By virtue of the rules of procedure, courts play an active supervisory role over lawyers' conflicts, but not over funder's conflicts in aggregate litigation. Indeed, the existence of third-party funders is, as a default matter, undisclosed to courts.[13]

Plaintiffs' inability to control aggregate litigation may very well partially account for their rising popularity as investments. (Other factors include the scale of the cases and the potential return, which justify the high transaction costs of litigation funding, and the diversification that mass torts, in particular, offer.)

3. Claim portfolios as undisclosed, unregulated aggregation devices, secondary markets, and moral hazards.

Economically speaking, claim portfolios are an aggregation device. Like class and mass actions, portfolios offer economies of scale with their attendant efficiencies (e.g., an opportunity to specialize)[14], diversification for the investors (lawyers and funders), and consequently can enhance access to justice by lowering the costs of legal services. Portfolios are also characterized by many of the same problems as class and mass actions: mainly, conflicts of interests between the lawyers and their clients and amongst claimants whose cases are aggregated, and incentives to bring non-meritorious cases.

Claim portfolios are not, however, a *procedural* aggregation device created by the legal system and supervised by the courts the way class and mass action mechanisms are; they are economic devices that are invisible to the courts and to defendants. They were not created by the legal system to enhance

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[8] The scholarship on these agency problems are legion, including [citations].

[9] [citations].

[10] [citations].

[11] See supra/infra.

[12] [citations].

[13] See Shook Hardy & Bacon, Third-Party Litigation Funding: State and Federal Disclosure Rules & Case Law (May 11, 2022).for a granular snapshot of the current state of disclosure obligations.

[14] [L&E on the economies of scale of aggregate litigation]

its own efficiency, to provide access to justice, and to incentivize private enforcement of the law. In fact, as discussed throughout this piece, they largely undermine all of these goals.

Economic aggregation via claim portfolios means that many of the agency and other problems inherent in procedural aggregation can now arise in cases far broader than those which would traditionally qualify for aggregation because any set of cases can be bundled in a portfolio. They do not need to be related as required to be joined as a class, MDL, or derivative actions. And one Nvidia-like runaway success can render any portfolio, irrespective of its contents, highly lucrative.

The potential abuses that procedural aggregation (class, mass and derivative actions) and economic aggregation (claim portfolios) share has led our system to deviate in the procedural aggregate litigation context from its adversarial nature and instead to adopt a managerial, and even inquisitorial model in which judges supervise key aspects of such cases in order to minimize risks to plaintiffs, defendants, and the courts themselves. Conversely, the problems that claims portfolios give rise to are channeled into arbitration, not the courts, obscuring portfolios' effects both in individual cases and systemically. By contrast, courts do not appear willing to apply unbridled market logic to legal claims as assets but rather are concerned with the special character of lawsuits as processes intended to resolve disputes and to enforce and develop the law for the benefit of both private parties and the public.[15]

The unregulated and undisclosed potential downside risk of economically aggregated cases is further increased, compared with that of procedurally aggregated cases, because funded portfolios are supported by secondary markets. Lawyers can shift some or all of the risk they take as financiers onto third-party financiers. Third-party financiers can further shift the risk onto anyone interested in purchasing an interest in legal claims. Some funding arrangements have a derivative nature[16] —investors acquire an interest pegged to the value of the claim rather than an interest in the claim itself—which makes them more liquid. This ability to shift risk creates a 'moral hazard': a situation where agents (lawyers) who are now insulated from risk may behave differently from the way they would behave if they were fully exposed to the risk.[17] Here, the moral hazard is that the risks of originating 'subprime' claims is eliminated by the ability to bundle them with meritorious ones and relatively easily sell them in secondary markets.

Lawyers' new roles as originators and brokers of portfolios of cases thus compound the well-known and well-understood conflicts of interests that already exist in aggregate litigation (mass and class actions) as well as those that exist in the funding of single (unbundled) cases. As some lawyers' and law firms' businesses cease to center around serving clients, and instead shift to centering on originating, brokering, and managing cases to the advantage of funders, with whom they often have repeat-play relationships and with whom they co-invest, lawyers' fiduciary role is placed under stress. This *financialization of litigation* into an unregulated asset class with nascent secondary markets risks

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[15] See, e.g., Burkhart v. Genworth Financial, C.A. No. 2018-0691-NAC (Court of Chancery of Delaware June 18, 2024) (unpublished opinion)

[16] I use 'derivative' here economically but depending on how they are structured litigation funding agreements may also fall under the definition of 'securities' under securities regulation law. [citations].

[17] Kevin Dowd, *Moral Hazard and the Financial Crisis*, 29 CATO J. 141, 142 (2009).

distorting our civil legal system from one designed to enforce rights and obligations and resolve disputes into one designed to maximize returns for lawsuit and law firm investors. As discussed throughout, the financialization of litigation, by necessity, distorts the traditional role of courts and of the attorney-client relationship.

PART II – PLAINTIFFS' AUTONOMY, DEFENDANTS' DUE PROCESS RIGHTS, THE INTEGRITY OF THE COURTS, AND THE PUBLIC INTEREST

In the real-world case upon which our hypo is based, a 2:1 majority of an international arbitral tribunal decided that freedom of contracts would render a provision that affords a funder settlement veto over a case valid.[18] This is incorrect. In that case, a petition to vacate the arbitral injunction award as against public policy, and a parallel petition to enforce it, ended up being settled before either court had an opportunity to rule on the question.[19] Had the courts been given the opportunity to rule, the question would have been a matter of first impression. No court in the U.S. has ever been requested, let alone agreed, to grant permission to a third-party funder to control settlement decisions. Conversely, numerous doctrines, rules of evidence, of procedure, and of professional responsibility, as well as court orders, recognize, and at times presuppose as axiomatic, the sanctity and centrality of a plaintiff's autonomy over their cases. This autonomy includes, *in particular*, control over settlement decisions. In this section, I examine these doctrines and rules. The mapping of these norms reveals the harms they seek to protect against that would be unleashed if funder control over settlement decisions was normalized. The harms span unfairness at the level of individual cases, damage to the civil justice system as a public institution serving the public good, and erosion of the attorney–client relationship. The affected constituencies are plaintiffs, defendants, courts and the public – in short, all of us.

A. Champerty 2.0: unconscionability, equity, abuse of process, and public policy.

The most fundamental doctrine in litigation finance law is champerty. In this section I will show that, contrary to a perception that champerty is progressively declining throughout the U.S.,[20] a close examination of doctrinal developments since the rise of third-party funding at the turn of the century shows a different pattern: champerty is alive and well in many states, including some that are important for litigation finance. Other states are moving away from champerty as an overly blunt tool while remaining firmly committed to its underlying policies. Where courts shift *away* from champerty,

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[18] *Sysco Corp. v. Glaz LLC*, No. 23-cv-1451 (N.D. Ill.)

[19] *See Glaz LLC. v. Sysco Corp.*, Case No. 1:23-cv-02489-PPG (S.D.N.Y); *Sysco Corp. v. Glaz LLC*, No. 23-cv-1451 (N.D. Ill.). [Minnesota Magistrate Decision; Illinois substitution decision.]. The public policy analysis of the lawfulness of substitution is different than that of third-party control since in a substitution scenario the former-third party now becomes the actual party.

[20] See, e.g. In Re Broiler Chicken Antitrust Litigation, No. 16 C 8637, ND IL Mem. Op. and Order 03/21/24. Cf. discussion of *Miller v. Caterpillar* and of *Todd v. Franklin* infra [xx, yy].

they are shifting *towards* other doctrines that do a better job in the 21st century of preserving and protecting policies which serve as the bedrock of civil justice without sacrificing the potentially beneficial aspects of third-party funding, which is primarily access to justice. To do this I will first give a brief background of champerty, then explain which policy goals it historically served, and next turn to a discussion of how courts have turned to the doctrines of unconscionability, equity, and public policy to advance the same goals. Finally, I will note that as courts become more aware of – and concerned by – litigation finance, some are beginning to apply the lens of abuse of process to financed claims.

1. Champerty and the foundations of civil justice.

It is important to understand champerty as both a bar on litigation finance in some jurisdictions and as a method for protecting several of the public policies that serve as the bedrock of our civil justice system. The doctrine can be somewhat confusing, since it nearly always arises as a challenge to the validity of a contract, and so can easily appear to be a contract doctrine – and thus susceptible to the rise of the freedom of contract and the consequent disfavor of restrictions on parties' ability to enter into a bargain of their choice. Champerty, however, is not contract law doctrine though it does often arise, in modern times, as a question of whether champertous contracts are void as against public policy (and historically also as contracts to commit a crime). When difficult questions about champerty come up, should courts find answers in the principle of the freedom of contracts? Or should they look to foundational principles like the sanctity of control over the conduct of one's claim? Those issues of interpretation are compounded by champerty's age and relative obscurity. The analysis in this subsection shows that the champerty doctrine has always been driven by the latter concerns and not the former. The next subsection shows that a handful of states are turning away from champerty and towards doctrines like unconscionability, equity and public policy. These doctrines are more finely tuned than champerty, and better understood. They also firmly aim the analysis at the question of whether a particular arrangement goes against important values and make it clear that when abuses that champerty historically protected against are present an exception to freedom of contract applies. A contract that leads to such abuses will still not be enforced in those jurisdictions. The final subsection notes that courts are increasingly aware of and concerned by litigation finance, leading some to appeal to general public policy norms and determine whether litigation finance arrangements might constitute an abuse of process.

'Champerty' is a form of 'maintenance,' two concepts that are centuries old and that were brought to the U.S. from England. Both, importantly, were torts and crimes at the common law.[21] Champerty and maintenance were eliminated as crimes and torts in England, and also in most (though not all) states in the U.S. – but the prohibition on champertous contracts became for the most part, enshrined in statute or as part of the common law, depending on the jurisdiction, independent of being a crime or a tort.[22] The United States Supreme Court succinctly defines the concepts thus:

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[21] 14 Am. Jur. 2d Champerty, Maintenance, Etc. § 1.

[22] Criminal Law Act 1967, c. 58, § 13 (UK); [citations].

"Maintenance is helping another prosecute a suit; champerty is maintaining a suit in return for a financial interest in the outcome."[23] The prohibition against champerty has its origins in ancient Greece and Rome where advocates before the court who exploited their influence over the judicial system to bully, harass, and intimidate others were known as "sycophants" in ancient Greece, "calumniators" in ancient Rome, and "maintainers" in medieval England.[24] The social context in which champerty matured, was one in which

> 'small men' transferred their rights of action in property disputes to 'great men' in order to get the great men's support at law. Because the legal establishment was weak at the time, the great men could overwhelm the court, thus enabling the little man to get his land claim and the great men to get their share. In other words, *champerty was a means by which great men increased their power at the expense of the courts of justice.*[25]

Champerty thus seeks to thwart "financial overreaching by a [funder with] superior bargaining position,"[26] compared to the finance recipients and to prevent powerful players from monopolizing the courts.

Contemporary cases often reference Black's Law Dictionary's definition: "[a] bargain by a stranger with a party to a suit, by which such third person undertakes to carry on the litigation at his own cost and risk, in consideration of receiving, if successful, a part of the proceeds or subject sought to be recovered."[27] Like historical case law, contemporary case law often focuses on third-party 'intermeddling'—the less powerful sibling of control—by a non-party in another's lawsuit. The *American Jurisprudence*, for example, defines a champertuer as one who "intermeddles in a suit of a stranger or is one not having any privity or concern in the subject matter, or standing in no relation of duty to the suitor."[28]

Control of another's suit is often an indication that prohibited champerty is present.[29] In the pivotal report that gave a stamp of approval to third-party funding in the U.S., the American Bar Association clarified that even in jurisdictions where champerty is permitted, it is allowed only insofar

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[23] *In re Primus*, 436 U.S. 412, 424 n.15, 98 S. Ct. 1893, 1900 n.15, 56 L. Ed. 2d 417, 429 n.15 (1978).

[24] *Osprey, Inc. v. Cabana Ltd. P'ship*, 532 S.E.2d 269, 273 n.2 (S.C. 2000).

[25] Steinitz, Whose Claim at 1287 (quoting *Thallhimer*, 3 Cow. at 644) (emphasis added). *See also* William R. Long, Champerty and Contingent Fees Part III, DRBILLLONG.COM (Dec. 13, 2005). http://www.drbilllong.com/LegalHistoryII/ChampertyIII.html.

[26] *Saladini v. Righellis*, 687 N.E.2d. 1224, 1226 (Mass. 1997).

[27] E.g., *Miller UK Ltd. v. Caterpillar, Inc.*, 17 F.Supp.3d 711, [xxx] (N.D.Ill. 2014) *quoting* Black's Law Dictionary (emphasis omitted*).*

[28] *See* supra note 12.

[29] *Maslowski v. Prospect Funding Partners LLC*, 994 N.W.2d 293 (Minn. 2023) (xxx); *Charge Injection Techs. v. E.I. Dupont De Nemours & Co.*, 2016 Del. Super. LEXIS 118 (finding an agreement non-champertous *because* of the absence of control); *Am. Optical Co. v. Curtiss*, 56 F.R.D. 26, 31 (S.D.N.Y. 1971). *See also*, Anthony J. Sebok, The Rules of Professional Responsibility and Legal Finance: A Status Update, Cardozo Legal Studies Research Paper No. 671, at 11 n.41 (2022).

as the supplier of funds does not engage in "intermeddling" with the litigation's conduct e.g., determining trial strategy or controlling settlements.[30]

Champerty is state law, embedded in either the common law or a statute, and there is a spectrum of approaches to it among the different states. California, for example, never had a champerty prohibition.[31] Some states, like Kentucky and Pennsylvania have, and recently reinforced, strong bans on champerty.[32] Others fall somewhere in between. For example, New York and Delaware maintain anti-champerty laws but interpret them in ways that generally allow litigation finance within specified constraints.[33]

The champerty prohibition, and the focus on preventing third-party intermeddling in particular, has had such longevity and near-universality[34] because it protects the integrity of the justice system from multiple threats and ensures it not be used for purposes other than its public functions – the pursuit of justice and the peaceful resolution of disputes. As the discussion of case law below shows, by ensuring litigation is brought *by and for an injured party*, champerty deters speculation in law suits, curbs excessive litigation, prevents the protraction of litigation particularly when brought by a non-party with no stake in the case, and protects against the extortion of defendants. Champerty aims to decrease meritless litigation as well as cases that would not otherwise be brought even if they are meritorious e.g., because the parties would seek to resolve the dispute privately without resort to litigation. And like many other doctrines and rules (discussed below), it seeks to promote settlement.

Importantly for our purposes, the champerty doctrine has long emphasized specifically various facets of the plaintiffs' autonomy and agency over their cases. One scholar has gone so far as to say that champerty [seeks to protect the authenticity of claims and prevent 'inauthentic claims' namely, allowing individuals who had not directly suffered a wrong to exert some control over a claim for redress related to a private injury endured by another.][35] The distinction between 'authentic' and

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[30] ABA COMM'N ON ETHICS 20/20 at 11 (2011).

[31] LISA BENCH NIEUWVELD & VICTORIA SHANNON, THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION xxx (2nd ed. 20xx).

[32] *See Buckhorn Res., LLC v. Combs Heirs, LLC*, No. 2018-CA-1073-MR, 2020 WL 6372558, at *2 (Ky. Ct. App. Oct. 30, 2020); *WFIC, LLC v. LaBarre*, 2016 PA Super 209, 148 A.3d 812, 819 (2016).

[33] N.Y. Jud. Law § 489 ("No [...] corporation or association, directly or indirectly, itself or by or through its officers, agents or employees, shall solicit, buy or take an assignment of, or be in any manner interested in buying or taking an assignment of [...] any claim or demand, with the intent and for the purpose of bringing an action or proceeding thereon…") and *Charge Injection Techs. v. E.I. Dupont De Nemours & Co.*, 2016 Del. Super. LEXIS 118.

[34] It existed throughout the Common Law world and, while not by that name, is a principle that can be found in other legal systems as well. NIEUWVELD & SHANNON, THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION xxx (2nd ed. 20xx).

[35] Anthony J. Sebok, *The Inauthentic Claim*, 64 Vand. L. Rev. 61, 94 (2011) (describing what confers "authenticity" to a claim, separately from legal validity, and why "inauthentic claims" [were traditionally viewed as] inconsistent with the goals and values of the common law); *see also Am. Optical Co. v. Curtiss*, 56 F.R.D. 26, 31 (S.D.N.Y. 1971) ("[funder-assignee] had nothing to do with the relationships between the individual defendants and the [original claimholder], which form the basis for the instant complaint. The assignment was merely a means to enable [the funder-assignee] to sue on behalf of the [original claimholder] and, as such, it contravenes [Section 489] and the public policy of New York. Accordingly… courts of New York would not enforce it as being contrary to the public policy of New York.").

'inauthentic' claims has traditionally been established based on the extent of control exercised over the claim:

> More common are limitations based on *how* the maintenance is performed. The most common way states control the *how* question in champerty is by limiting how much *control* the investor has over the conduct of the litigation into which she has put her money. We can say, therefore, that states sometimes limit *intermeddling profit maintenance*: where a contract allows the third party to take too much control over the conduct of what otherwise would be a meritorious suit by another, the maintenance will be prohibited.[36]

In sum, champerty does a heavy lift, protecting a variety of values and interests, including those of the courts and the public, plaintiffs, potential defendants (against non-meritorious claims), and actual defendants. Importantly, any reader familiar with the main policy debates relating to civil litigation, especially mass torts and class actions, in recent decades will immediately recognize that these interests and concerns remain viable, indeed - central, today. Scholarship about mass torts and class actions is nothing if not full of analyses on how to avoid inauthentic claims (traditionally understood to be brought by entrepreneurial lawyers who 'hire' clients rather than the other way around); avoid incentives to bring non-meritorious cases; prevent lawyer-funders (contingency fee lawyers) either prolonging cases or settling them too soon for their own benefits, and similar conflicts between lawyer-funders and their clients.[37]

a. Control

During the late nineteenth and early twentieth centuries, two notable exceptions to the champerty doctrine emerged. The first was the contingency fee, whereby lawyers, acting as fiduciaries for the financed parties and bound by ethical regulations, are permitted to finance litigation. The second was insurance, which became acceptable but entailed imposing fiduciary or quasi-fiduciary obligations and a complex regulatory scheme designed to protect both the insureds and broader society.[38] Thus, champerty became permissible in specific contexts where fiduciary duties and regulatory oversight safeguard the interests of the funded party—plaintiffs in the case of contingency fees, and defendants in the case of insurance—the courts, and the public.

In the beginning of the twenty-first century, third-party funding emerged and, as a market force, carved a place for itself as a new, third form of champerty. TPLF's achieved a measure of acceptability and mainstreaming by assuaging concerns from legislators, courts, the legal profession, and the public that their involvement will not undermine the attorney-client relationship. They have

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[36] Sebok, *supra* n.xx at 109 (emphasis in original).

[37] *See, e.g.*, John C. Coffee, Jr., *The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency in the Large Class Action*, 54 U. Chi. L. Rev. 877 (1987); [citations]

[38] [citations].

assured all those stakeholders that third-party funding will not encourage non-meritorious litigation nor prolong cases, which would further burden the already overextended court system. Crucially, they have emphasized that plaintiffs will retain control over their cases generally and specifically with regard to settlement decisions.[39]

A recent Delaware case is a case in point. *Charge Injection Techs, Inc. v. E.I. Dupont De Nemours & Co.* illuminates and illustrates champerty doctrine's focus on the question of control: "in a vigorously litigated Delaware case, the trial court held that a third-party financing agreement did not constitute champerty or maintenance because the funder did not have the contractual right to control the litigation, nor did it have de facto control over the conduct by counsel of the litigation."[40] This case is especially noteworthy because it discusses two kinds of control: one, obtained via contract the other, *de facto* control via influence over counsel.[41] The court found that *both* kinds of control are relevant in analyzing whether an agreement is champertous.

In *Boling v. Prospect Funding*, decided in 2019, a litigation funder contended that Kentucky's champerty law lacks a clear policy against litigation funding agreements. However, the Sixth Circuit, interpreting Kentucky law, affirmed the District Court's judgment that the agreement was champertous. The court found that the terms gave the funder significant control over the litigation, imposed conditions that compromised a plaintiff's independence, and could interfere with or discourage settlement.[42]

New York, perhaps the most important jurisdiction in the litigation funding context given its role in commerce, maintains its statutory champerty prohibition (which includes exceptions generous enough to allow many forms of contemporary litigation funding).[43] In recent years, New York courts generated some convulsions in the litigation funding world when, on a couple of occasions, it held agreements to be champertous under its law,[44] thus signaling that rumors of the death of champerty in the jurisdiction have been greatly exaggerated. Further, New York's statute explicitly prohibits soliciting, buying, or taking an assignment, which, according to its plain language, includes indirect

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[39] ABA COMM'N ON ETHICS 20/20 INFORMATIONAL REPORT TO THE HOUSE OF DELEGATES 23 n. 82 (2011), *available at https://lowellmilkeninstitute.law.ucla.edu/wp-content/uploads/2019/02/ABA-White-Paper-on-Litigation-Finance.pdf*, quoting COMMENTS OF JURIDICA CAPITAL MGMT. LTD. TO THE AM. BAR ASS'N WORKING GROUP ON ALTERNATIVE LITIG. FIN. 6 (Feb. 17, 2011). Omni Bridgeway has explained that "[t]ypically… litigation funders take a 'light touch' approach to case management. Litigation funders are not permitted to exercise control over the lawyers' strategy decisions and generally are afforded limited rights in this regard under the LFA. The right to be informed, including of settlement offers and major case developments, is a fairly common one." *Litigation Finance*, Omni Bridgeway, *available at* https://omnibridgeway.com/litigation-finance.

[40] *Charge Injection Techs, Inc. v. E.I. Dupont De Nemours & Co.* at xx.

[41] *Id.* at xx [quote].

[42] *Boling v. Prospect Funding Holdings LLC*, 771 Fed. Appx. 562, 580 (6th Cir. 2019).

[43] N.Y. Jud. Law § 489(1).

[44] *Justinian Capital SPC v. WestLB AG*; *Phoenix SF Light, Ltd., et al v. U.S. Bank National Association and Bank of America NA; Echeverria v. Estate of Lindner,* 801 N.Y.S. 2d 233, 2005 WL 1083704 (N.Y. Sup. Ct. 2005) (unreported)*; Leasing Control Inc. v 500 Fifth Ave., Inc.*. [xxx].

assignments of claims.[45] If and when faced with the question of whether obtaining control over litigation constitutes an 'indirect assignment' a New York court would likely consider the public policies underlying the prohibition on champerty – including the courts' general disapproval of attempts to control a claimholder's decisions regarding their litigation.[46]

In the 2014 case of *Miller v. Caterpillar*, the U.S. District Court for the Northern District of Illinois examined whether Illinois' maintenance statute applied to Miller's agreement with a third-party litigation financier. The statute states that "if a person officiously intermeddles in an action that in no way belongs to or concerns that person, by maintaining or assisting either party, with money or otherwise, to prosecute or defend the action, with a view to promoting litigation, he or she is guilty of maintenance...".[47] The court focused on defining 'officious intermeddler' and concluded that it refers to someone who initiates litigation that otherwise would not have occurred, prolongs litigation that would otherwise settle, pursues meritless litigation, or litigates for harassment purposes. The court determined the funding agreement did not violate the statute, but the case clearly showed that champerty and maintenance remain significant concerns in Illinois.

b. Unconscionability, equity, and public policy.

States such as Massachusetts,[48] Ohio,[49] and Minnesota[50] have abolished the champerty doctrine, opting instead for more finely-tuned frameworks such as unconscionability, overarching principles of equity, and public policy considerations. In these and other jurisdictions that have loosened or even eliminated champerty, courts still reject what has traditionally been called 'officious intermeddling'—encouraging the filing of claims, influencing the litigation, prolonging litigation, interfering with lawyers' independent judgment, and outright controlling the litigation. This is especially true when the 'intermeddling' limits a client's autonomy over settlement decisions. As the ABA summarized, in jurisdictions where champerty is permitted, "[it] is generally permissible as long as the supplier is not... 'intermeddling' with the conduct of the litigation (e.g., determining trial strategy

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[45] N.Y. Jud. Law § 489(1) ("No [...] corporation or association, directly *or indirectly*, itself or by or through its officers, agents or employees, shall solicit, buy or take an assignment of, or be in any manner interested in buying or taking an assignment of [...] any claim or demand, with the intent and for the purpose of bringing an action or proceeding thereon…" (emphasis added)).

[46] *See supra*, xx.

[47] *Miller UK Ltd. v. Caterpillar, Inc.*, 17 F. Supp. 3d 711, 725 (N.D. Ill. 2014) (quoting 720 ILCS 5/32-12). Illinois has both a maintenance statute, 720 ILCS 5/32-12, and a common law champerty doctrine. ""The law, however, does not permit a person having no interest in the subject matter of a suit to become interested in it and concerned in its prosecution, and an agreement by which such person, although an attorney, agrees to bear expense and costs of litigation falls within the definition of champerty, and will not be enforced, either at law or in equity." *Geer v. Frank*, 179 Ill. 570, 575, 53 N.E. 965, 966 (1899). *See also In re Reed*, 532 B.R. 82, 93 (Bankr. N.D. Ill. 2015).

[48] *Saladini v. Righellis*, 687 N.E. 2d 1224 (Mass. 1997).

[49] Ohio Rev. Code Ann. § 1349.55.

[50] *Maslowski v. Prospect Funding Partners LLC*, 994 N.W.2d 293 (Minn. 2023).

or controlling settlement)."[51] What has changed in jurisdictions that have updated their approach to champerty is that the prevention of officious intermeddling is accomplished through doctrines like unconscionability, equity and a direct appeal to public policy. These tools have the benefit of being not only more flexible but also potentially broader than champerty. Thus, they may be used to more easily limit abusive litigation funding practices. Simultaneously, they operate in a way that will not eliminate a private market solution to access to justice problems. I call these doctrines, as applied to litigation finance, 'Champerty 2.0' and courts' treatment of them show that the spirit of champerty is very much alive.

An example of this more tailored approach can be seen in *Maslowski v. Prospect Funding*, a case in which the Minnesota Supreme Court abolished the state's common law doctrine of champerty but emphasized that this does not render all previously champertous agreements enforceable as written.[52] The court emphasized that, although it was abolishing champerty, "[p]arties like Maslowski retain the common law defense of unconscionability", a "mechanism for protecting individual parties from unfair or inequitable contracts (including litigation financing agreements)".[53] The court further noted that "[c]ourts and attorneys should likewise be careful to ensure that litigation financiers do not attempt to control the course of the underlying litigation, similar to the 'intermeddling' that we described in our early champerty precedent."[54]

As to plaintiffs' control over their cases, the Minnesota Supreme Court reiterated and reinforced the general principle that "it is difficult to conceive of any stipulation more against public policy than a contract term requiring the litigation financier's permission to settle the underlying litigation."[55] Following this direction, on remand, Minnesota's trial and appellate courts found a portion of the funding contract unconscionable because the

> agreement unconscionably interfered with Maslowski's decisions as to her legal claim… Restricting Maslowski's freedom to enter into settlements and imposing a fixed penalty on her if she fails to 'use reasonable efforts' to protect [the funder's] interests offends the [] principle [that] an outside party may not influence a litigant's efforts to settle a legal claim.[56]

Similarly, the Supreme Court of South Carolina noted, in *Osprey v. Cabana*, that the abolition of champerty as a defense does not imply that agreements that would have previously been voided are now enforceable.[57] The Court listed several factors that could render a funding agreement

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[51] ABA COMM'N ON ETHICS 20/20 at 11.

[52] *Maslowski v. Prospect Funding Partners* LLC, 944 N.W.2d 235, 241 (Minn. 2020) (quoting in agreement *Osprey, Inc. v. Cabana Limited Partnership*, 340 S.C. 367, 532 S.E.2d 269 (S.C. 2000)).

[53] *Maslowski II (2023): https://casetext.com/case/maslowski-v-prospect-funding-partners-llc-7*

[54] *Id.* at xx.

[55] *Id.* at 238 (citing and quoting *Huber v. Johnson*, 70 N.W. 806, 808 (Minn. 1897)) (internal quotation marks omitted).

[56] *Maslowski v. Prospect Funding Partners LLC*, 978 N.W.2d 447, 456, 457 (Minn. Ct. App. 2022).

[57] *Osprey, Inc. v. Cabana Ltd. P'ship*, 340 S.C. 367, 382 (S.C. 2000).

unenforceable, including whether "the financier engaged in officious intermeddling." The Court explained that a financier becomes an officious intermeddler by offering unsolicited advice or attempting to control litigation to stir up strife or prolong frivolous lawsuits.[58] In other words, 'officious intermeddling' encompasses more than control; even unsolicited advice may suffice to breach public policy.

Again, we see a judicial retreat from champerty, not due to indifference towards its underlying public policies, but because "other well-developed principles of law can more effectively accomplish the goals of preventing speculation in groundless lawsuits and the filing of frivolous suits."[59]

In Illinois, champerty remains a viable common law doctrine, and maintenance is statutorily prohibited. While Illinois courts have, to an extent, moved away from strict common law definitions, they still aim to uphold the public policies against champerty, focusing on preventing the commercialization of disputes. "While the common-law crime of champerty has not been abolished by statute in this State, the tendency of decisions is to depart from the severity of the old law and at the same time to preserve the principle which tends to defeat the mischief to which the old law was directed, namely, 'the traffic of merchandizing in quarrels, of huckstering in litigious discord.'"[60] In *Todd v. Franklin*, the U.S. District Court for the Northern District of Illinois found that although the actions of an assignee to whom Todd assigned his claim did not meet the technical definitions of the champerty his "actions are *close enough* to champerty and barratry to bolster [the] argument that the assignment of [the] claims in this case violates Illinois *public policy*."[61] Namely, the court voided the assignments *directly* based on champerty's public policy with something less than champerty. This case also illustrates that champerty 2.0 can be broader, grabbing scenarios that would not neatly fit the definition of champerty.

These cases illustrate that across different jurisdictions and over time, courts consistently express the same fundamental concerns. While some states are relaxing champerty prohibitions to facilitate litigation funding and enhance access to justice, they are doing so with clear caveats against officious intermeddling, ensuring that third-party funding does not undermine the autonomy of plaintiffs, the rights of defendants, and the independent judgment of attorneys.

2. Abuse of process and the real party in interest rule.

The concept that best captures most, if not all, of the main concerns that third-party funding gives rise to—(1) the disclosure debate about whether, when, and how are defendants entitled to know about third party funding of their opponents;[62] (2) the fear of flooding the courts with non-meritorious

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[58] *Id.* at 383.

[59] *Id.* at 381.

[60] *Berlin v. Nathan*, 64 Ill. App. 3d 940, 956, 381 N.E.2d 1367, 21 Ill. Dec. 682, (1st Dist. 1978) (quoting *Milk Dealers Bottle Exch. v. Schaffer*, 224 Ill. App. 411, 415 (1st Dist. 1922)).

[61] *Todd v. Franklin Collection Serv., Inc.*, No. 11 C 6128, 2011 WL 6140863, at *4 (N.D. Ill. Dec. 9, 2011), aff'd, 694 F.3d 849 (7th Cir. 2012) (emphasis added)).

[62] [Scholarship, federal bills, and recent state legislation on disclosure]

litigation; (3) the fear of plaintiffs' loss of control over their cases; and (4) the fear that foreign entities and governments will use the American court system for improper ends[63]—is that of *abuses of process*. All of the aforesaid can be understood as just that: abuse of the legal process for purposes foreign, and even antagonistic, to the functions of the civil justice system which are dispute resolution, enforcement of rights and obligations, and development of the law. The doctrine of abuse of process has therefore crept up, though not as often as one might expect, in challenges to third-party funding practices that some regard as abusive. One way to limit abuses of process is to ensure that the real party in interest is before the court. The entwined nature of abuses of process, the real party in interest, and the question of who controls the litigation – including the decision to file and settle – and lawyers' misplaced loyalties are illustrated in a highly publicized recent case, *Nimitz Techs. LLC v. Cnet Media, Inc.*

To protect and promote transparency in his court's proceedings, on April 18, 2022, Judge Connolly of the District Court for the District of Delaware issued two standing orders. The first directed each party to "include in its disclosure statement [...] 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."[64] In discussing his reasons for issuing the order, Judge Connolly noted that it "promotes the identification of the real parties in interest in a case."[65] The second required disclosure in all cases of a) the identity of any third-party funder; b) a statement indicating whether the funder's approval is required for settlement; and, c) a description of the funder's interest.[66] The Third-Party Funding order requires affirmative disclosure of the existence of funders but does not require any filing where no funder exists. .

Nimitz Technologies LLC ("Nimitz") filed four patent enforcement cases in Judge Connolly's court. Initially it failed to file either the statement required by the Disclosure Order or any statement pursuant to the Third-Party Funding Order. After being prompted (twice) by the Court, Nimitz certified that it had a single owner, Mark Hall, and no third-party funder.[67] Because of revelations in a series of other cases which at first blush seemed unrelated, Judge Connolly began to suspect that IP Edge, a well-known patent monetization firm, was assigning its patents to shell companies in order to have those companies bring suit -- and that those companies were systematically failing to disclose IP Edge as a third-party funder. "Based on the totality of this information, [Judge Connolly was concerned that Nimitz and the [plaintiffs in other cases] may not have complied with the Third-Party

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[63] This concern has caught the attention of Congress, where Republican legislatures have recently held hearings on the topic and advanced proposed legislation that would require disclosing the identity of foreign litigation funders. [bill(s) in Congress and letter of Republican AGs.]

[64] Standing Order Regarding Disclosure Statements Required by Federal Rule of Civil Procedure 7.1 (the Disclosure Order).

[65] Memorandum 11/30/2022.

[66] Standing Order Regarding Third-Party Funding Arrangements (the Third-Party Funding Order).

[67] Memorandum 11/30/2022.

Funding Order, as none of those parties had disclosed a funding arrangement with IP Edge."[68] He therefore called for evidentiary hearings.

At the hearing it became clear that the nominal owners of the LLCs bringing these related claims -- the ones who, according to filings in the Patent and Trademark Office, had acquired all rights, title, and interest in the patents which were the subject of the suits -- had little to no grasp of the economics of the agreement they'd entered into, no understanding of patents or patent litigation either generally or in the specific instances of the patents they nominally owned, and no contact with the counsel purporting to bring and settle these actions on their behalf. They had been marketed a source of "passive income" by a consulting firm, Mavexar. By agreeing to become the principal of an LLC formed by Mavexar; accepting assignments of patents facilitated by Mavexar; and then proceeding with patent litigation using counsel selected, paid, and directed by Mavexar, the nominal owners were entitled to somewhere between 5% and 10% of the recovery while being liable for 100% of the attorneys' fees and other costs not covered by proceeds of the claims.

Judge Connolly concluded the evidentiary hearing by noting that "I think the testimony has to give pause to anybody who really is concerned about the integrity of our judicial system, the abuse of our courts, and potential abuse, lack of transparency as to who the real parties before the Court are, about who is making decisions in these types of litigation."[69] He then issued an order requiring Nimitz and the other plaintiff LLCs, their counsel, and Mavexar to disclose records of their dealings. The United States Court of Appeals for the Federal Circuit denied Nimitz's appeal of that order.[70] After multiple appeals and motions to set aside the order, Nimitz and the other LLC plaintiffs provided at least some of the required documents.[71]

In light of the revelations, Judge Connolly referred the attorneys representing Nimitz and the other LLC plaintiffs for discipline for violating their fiduciary duties to their ostensible clients, and referred the attorneys working at IP Edge/Mavexar for discipline for the unauthorized practice of law. With respect to the attorneys for the plaintiffs, Judge Connolly reasoned that "[i]t appears that counsel violated both Rule 1.2(a) and Rule 1.4 by failing to have any communication with their clients before filing, settling, and dismissing the clients' cases [...] [and that i]t also appears that counsel violated Rule 1. 7 and, to the extent their fees were paid or advanced by Mavexar or IP Edge, Rule l.8(f). As an initial matter, by failing to communicate with their clients, counsel violated their obligation to ascertain at the outset of their representations whether a conflict or potential conflict existed.

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[68] Memorandum 11/30/2022.

[69] D .I. 26 at 107: 14-108 :3.

[70] *In re Nimitz Techs. LLC*, 2022 WL 17494845, at *3 (Fed. Cir. Dec. 8, 2022).

[71] Memorandum Opinion p. 6. Among the details discovered in the investigation were the facts that Nimitz did not even exist when the counsel ostensibly representing it was contacted by IP Edge to draw up the complaints that Nimitz would eventually file. Someone with an IP Edge email address submitted to the PTO the assignment of the patent to Nimitz in Mark Hall's name. Hall, recall, was the sole owner of Nimitz. A foreign government, France, retained a 35% interest in proceeds from patent enforcement. The attorney purporting to represent Nimitz never contacted Hall before filing 21 cases in three courts in the name of Nimitz or before agreeing to settlements in 13 of them. The relationship between IP Edge and Mavexar is not entirely clear, but Judge Connolly concluded that "[t]he documents produced [...] make clear that numerous Mavexar and IP Edge actors engaged in the practice of law on behalf of Nimitz [and the other LLC plaintiffs]." Memorandum Opinion p. 96.

Beyond that, the terms of Mavexar's consulting services agreements with counsel's clients created at least potential conflicts of interest between Mavexar and the clients. Because of those potential conflicts, counsel's blind adherence to Mavexar' s directions to file and settle cases in the clients' names created a significant risk that counsel's actions materially limited their representations of their clients."[72] He also sent his findings to the Department of Justice for further investigation based on his conclusion that "(1) counsel of record for the LLC plaintiffs violated numerous rules of professional conduct by actions they took and failed to take; [] and (3) real parties in interest in the patents in these cases, including a foreign government, were not disclosed to the [Patent and Trademarks Office], defendants, or the Court."[73]

The case illustrates, once again, the connection between funders' control, lawyers' conflicts of interest, and abuses of process. None of these abuses of process, violations of ethical obligations, nor suspected frauds upon the court and the PTO would have been brought to light without Judge Connelly's willingness to assume an active role in investigating potential abuses. *Nimitz* also illustrates the wisdom behind Rule 17(a) of the Federal Rules of Civil Procedure (and its state analogues) according to which a lawsuit "must be prosecuted in the name of the real party in interest."[74] It shows how a lack of transparency as to the real party in interest – the party in control of the litigation – creates the conditions for abuses of process. A party who controls a case is a real party in interest, they should be transparent to the courts and the parties, otherwise, abuses of process are likely, even – inherent. Therefore, on a number of occasions in recent years, a discovery of funders' control has led to a finding that the funder is the real party in interest.[75]

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[72] Memorandum Opinion pp. 85-88.

[73] *See* Nimitz 2022 WL 8187441, *supra* note 1.

[74] Fed. R. Civ. P. 17(a)(1).

[75] *Abu-Ghazaleh v. Chaul*, 36 So. 3d 691, 693–94 (Fla. Dist. Ct. App. 2009) (individual and corporation funding litigation were "parties" to a civil theft lawsuit brought by shareholders and, thus, could be held liable to pay attorney's fees and costs even though they were not named in the pleadings, because they entered into an agreement pursuant to which they paid litigation costs, approved counsel, had veto power over the filing and manner of prosecution of the lawsuit, had the final say over any settlement agreements, and were entitled to 18.33% of any amount awarded to the shareholders). In *Am. Optical Co. v. Curtiss*, the Southern District of New York held that an agreement which limited the litigant's control over whether to sue violated Federal Rule of Civil Procedure 17(a), which requires the moving party to be the "real party in interest. *Am. Optical Co. v. Curtiss*, 56 F.R.D. 26, 29–32 (S.D.N.Y. 1971) ("Corporations cannot maintain actions on claims which, in violation of the Penal Law, are assigned to the corporation for the purpose of bringing suit thereon."). See also, *Navarro Sav. Ass'n v. Lee*, 446 U.S. 458, 464, 100 S. Ct. 1779, 64 L. Ed. 2d 425 (1980) (finding that a trustee had been assigned claims because the beneficiaries could not "control the disposition of this action . . . except in the most extraordinary situations."); *Nat'l Credit Union Admin. Bd. v. HSBC Bank US, Nat'l Ass'n*, 331 F.R.D. 63, 72 (S.D.N.Y. 2019) (a trustee was the 'real party in interest' because the trust agreement gave him "control over the claims" necessary to qualify as a real party in interest). *Maslowski v. Prospect Funding Partners* LLC, 944 N.W.2d 235, 238 (Minn. 2020). The trustee in the highly publicized bankruptcy of Girardi Keese law firm has alleged that repeat play funders have exerted such control or influence over the now-disbarred attorney, Thomas Girardi, that the funders are "'implied in fact' partners of Girardi Keese, or, alternatively, that the [funders] are 'insiders' of Girardi Keese." *A New Threat*, *supra* note [XX], at 9 (quoting Complaint ¶ 11, *Miller v. Counsel Fin. Servs., LLC* (In re Girardi Keese), No. 2:20-bk-21022-BR, ECF No. 1333 (Bankr. C.D. Cal. filed Aug. 31, 2022)).

More broadly, the public policies underlying the real party in interest rule include promoting due process by making sure defendants know who they are facing so they can fully participate in the adversarial process; protecting the public record regarding the facts at issue in court cases as required by the rule of law;[76] and making sure courts and counsel are able to identify potential conflicts of interest. *Nimitz* also illustrates a scenario in which a foreign government is the real party in interest, a scenario that has recently caught the attention of Congress and states attorneys general.[77] Certain areas of law, such as antitrust law, envision private enforcement of the law for the public benefit. For that reason, such laws afford incentives such as treble damages to induce private parties to enforce antitrust law. If third-party funders are now becoming 'private attorneys general' this should be transparent so that the public can scrutinize how this function is exercised by such players.[78] Similarly, class actions are a device often justified on grounds that it provides private enforcement of the law. The cost to the public and to private parties from the downsides of class actions, such as the incentivization of strike suits and high compensation for the lawyers, is often justified by this socially beneficial function and the notion that the private bar is acting as private attorneys general.[79] The changes that third-party funding introduces to any specific class action, as well as to the system of class actions, should similarly be transparent to the public.

3. The Public Policy in Favor of Settlements: Federal and States' Rules of Civil Procedure and of Evidence.

Agreements purporting to grant a third-party control over settlement decisions also run afoul of a strong public policy, at both the state and federal level, of favoring settlements: "It is axiomatic that the law encourages settlement of disputes."[80]

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[76] *Guerrilla Girls, Inc. v. Kaz*, 224 F.R.D. 571, 573 (S.D.N.Y. 2004) (adversaries' and public's interest in knowing the real party in interest).

[77] *The U.S. Intellectual Property System and the Impact of Litigation Financed by Third-Party Investors and Foreign Entities, H. Judiciary Subcomm. on Cts., Intell. Prop., and the Internet*, 118th Cong. (2024); *Unsuitable Litigation: Oversight of Third-Party Litigation Funding, H. Comm. on Oversight and Accountability*, 118th Cong. (2023); Litigation Funding Transparency Act, S. 840, 117th Cong. (2021); Protecting Our Courts From Foreign Manipulation Act, S. 2805, 118th Cong. (2023).

[78] *Hawaii v. Standard Oil Co.*, 405 U.S. at 262 ("By offering potential litigants the prospect of a recovery in three times the amount of their damages, Congress encouraged these persons to serve as 'private attorneys general.'"). Congress and the courts have made it clear that the public has an interest in ensuring that *the injured party* is the one bringing suit. 5 U.S.C. § 15(c), titled "Suits *by persons injured,*" states: "…*any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue* therefore in any district court of the United States… and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee.") (italics added). See also, Robert H. Lande & Joshua P. Davis, *Benefits From Private Antitrust Enforcement: An Analysis Of Forty Cases*, 42 U.S.F. L. Rev. 879, (2008) ("The legislative history and case law interpreting the federal antitrust laws indicate that one important goal of the laws is to compensate victims of illegal behavior." *Id.* at 881–882) quoting *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 486 n.10 (1977) ("Treble-damages antitrust actions ... [were] conceived of primarily as a remedy for [t]he people of the United States as individuals, especially consumers....").

[79] See, supra [class action literature].

[80] *Bano v. Union Carbide Corp.*, 273 F.3d 120, 129 (2d Cir. 2001) (collecting federal cases). *See also*, *In re Sony Corp. SXRD*, 448 F. App'x. 85, 87 (2d Cir. 2011) ("Public policy favors settlement."); *Snyder v. Wells Fargo Bank, N.A.*, No. 11 Civ. 4496(SAS), 2011 WL 6382707, at *4 (S.D.N.Y. Dec. 19, 2011) ("there is always a strong federal policy in

The preference for settlement is evident throughout the federal rules of procedure and of evidence. Rule 16(a)(5) of the Federal Rules of Civil Procedure, for instance, encourages pre-trial conferences that have as one of their goals "facilitating settlement." And Rule 408 of the Federal Rules of Evidence, incentivizes settlement talks by barring introduction at trial of information or offers from those talks in order to prove liability. "The primary policy reason for excluding settlement communications is that the law favors out-of-court settlements, and allowing offers of compromise to be used as admissions of liability might chill voluntary efforts at dispute resolution."[81] Federal courts also have local rules designed to facilitate settlements.[82]

In an example of the same policy at the state level, New York law clearly reflects a policy preference for encouraging settlement. Non-settling defendants, for example, cannot seek contribution from defendants that have settled.[83] Parties must undertake settlement negotiations as part of a litigation.[84] New York law protects settlement communications in the same way the federal law does.[85] In 2004, the New York Court of Appeals reinforced "[its] State's strong policy promoting settlement..."[86] In fact, a New York court went so far as to state that an agreement which "gave [the

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favor of early and amicable settlement."); *Gupta v. Headstrong, Inc.*, No. 17-CV-5286 (RA), 2018 WL 1634870, at *3 (S.D.N.Y. Mar. 30, 2018) ("Federal courts likewise have 'articulated a strong policy in favor of enforcing settlement agreements and releases.'") (citation omitted); *Howell v. Motorola, Inc.*, 633 F.3d 552, 561 (7th Cir. 2011) (recognizing the "importance of the federal policy in favor of voluntary settlement of claims"); *Petrovic v. Amoco Oil Co.*, 200 F.3d 1140, 1148 (8th Cir. 1999) ("[A] strong public policy favors agreements, and courts should approach them with a presumption in their favor.") (quoting *Little Rock Sch. Dist. v. Pulaski Cnty. Special Sch. Dist. No. 1*, 921 F.2d 1371, 1388 (8th Cir.1990)).

[81] *Zuric Am. Ins. Co. v. Watts Indus., Inc.*, 417 F.3d 682, 689 (7th Cir. 2005).

[82] See, e.g., Local Rules of the United States District Court for the Northern District of Illinois, Rule 16.1.5, https://www.ilnd.uscourts.gov/_assets/_documents/_rules/LRRULES.pdf (requiring counsel and the parties in civil cases to "undertake a good faith effort to settle that includes a thorough exploration of the prospects of settlement" in advance of trial).

[83] N.Y. GEN. OBLIG. LAW § 15-108(b) (McKinney 2007).

[84] N.Y. UNIFORM RULES FOR N.Y. STATE TRIAL CTS. §§ 202.12(c)(5), § 202.26, https://ww2.nycourts.gov/rules/trialcourts/202.shtml.

[85] *See, e.g., In re Gordon v. Vill. of Bronxville*, 5 Misc. 3d 1030(A), 4 (Sup. Ct. Westchester Cnty. 2004) (noting the well-settled law in New York that "'[a]dmissions of fact explicitly or implicitly made "without prejudice" during settlement negotiations are protected from discovery pursuant to the public policy of encouraging and facilitating settlement'"); *Baghoomian v. Basquiat*, 167 A.D.2d 124, 1125 (1st Dep't 1990) (citation omitted) ("Public policy encourages the settlement of lawsuits and directs that judges and their law assistants take part in settlement conferences without fear that they may be called to testify about materials or information obtained during these private conferences.").

[86] *Bonnettev. Long Island College Hosp.*, 3 N.Y.3d 281, 286 (2004). *See also Booth v. 3669 Del., Inc.*, 92 N.Y. 2d 934, 935 (1998) (noting "the public policy favoring enforcement of settlements"); *In re Feinerman,* 48 N.Y. 2d 491, 500 (1979) (noting that in certain cases the courts must balance the policy underlying a statute with the "competing public policy favoring the nonjudicial resolution of legal claims"); *Mahoney v. Turner Constr. Co.*, 61 A.D.3d 101, 106 (N.Y. App. Div. 1st Dep't 2009) ("We recognize that '[s]trong public policy considerations favor settlements, which avoid costly litigation and preserve scarce judicial resources.'").

attorney] a veto over any settlement may be found to have violated Rules of Professional Conduct."[87] The court relied on *In re Snyder*, where the Court of Appeals explained that:

> "more important than any such personal and private considerations is the one of public concern that such contracts would prove added obstacles to that quieting of disputes and to that adjustment and settlement of litigation which always has been and always should be favored by the acts of legislatures, the decisions of courts and the expressions of public opinion. For, in my judgment, there is no need of long argument to demonstrate that such contracts would prove such obstacles. We have before us in this very litigation an illustration of the manner in which they would be utilized if so permitted to prevent settlements even when the attorney and client were involved in no other differences than those of an honest opinion about the amount which ought to be realized from the litigation."[88]

Although the court there was referring specifically to an agreement between a claimant and counsel, the reasoning it offers is the same as underlies the general and well-settled judicial preference for settlement and the disfavor with which courts view obstacles to settlement.

The strong public policy favoring settlement is widely recognized in scholarly literature.[89] Settlement is in the public interest because it lightens the load on the judiciary; clears the way for other cases to proceed apace; avoids the expense of trial for litigants and taxpayers alike; and conserves the private resources of the litigants. Further, litigants who settle are more satisfied with the outcomes of their cases.[90]

4. Plaintiffs' autonomy, the attorney-client relationship, and the Rules of Professional Conduct.

Client's autonomy and agency is the foundation of the attorney-client relationship which is an agency relationship. The lawyer is an agent and fiduciary of the client: "The *touchstone* of the client-lawyer relationship is the lawyer's obligation to assert *the client's position* under the rules of the adversary system...".[91] This principle runs through the rules of professional conduct in every one of the fifty

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[87] *Freeman Lewis LLP v Financiera De Desarrollo Indus. y Com. S.A.*, 172 A.D.3d 574, 575 (N.Y. App. Div. 1st Dep't 2019).

[88] *In re Snyder*, 190 N.Y. 66, 71 (1907). *See also Anderson v. Itasca Lumber Co.*, 91 N.W. 12, 13 (Minn. 1902) ("To hold as we are asked to do by respondent would give attorneys the power to prolong litigation at their will, regardless of the interests or desires of their clients; and it is for this very reason that the clause referred to in the contract prohibiting settlement without the consent of the plaintiff has been declared by the courts to be void, as against public policy.").

[89] [Academic literature.]

[90] *Kalinauskas v. Wong*, 151 F.R.D. 363, 365 (D. Nev. 1993); *In re N.Y. Cnty Data Entry Worker Prod. Liab. Litig.*, 162 Misc. 2d 263, 267 (Sup. Ct. N.Y. Cnty. 1994), *aff'd*, 222 A.D.2d 381 (1st Dep't 1995).

[91] N.Y. Rules of Pro. Conduct, Preamble para. 2 (N.Y. State Bar Ass'n 2021) (emphasis added).

states. For example, with respect to the duty to exercise independent judgment, the rules state that "[t]he professional judgment of a lawyer should be exercised, within the bounds of the law, *solely for the benefit of the client* and *free of compromising influences and loyalties*."[92]

With regards to control over settlement decisions, in particular, the rules of professional conduct in all fifty states ensure that clients always have the right to accept or reject a settlement proposal.[93] A lawyer must abide by a client's decisions concerning the objectives of the representation, including and especially a client's decision whether to settle a matter.[94] The sanctity of clients' control over settlement decisions is derived from the more general protection of clients' control over fundamental legal decisions, such as a client's decision to write a new will or a decision whether to plead guilty to a crime.[95] The reason is always the same: litigation "concerns a client's affairs and is intended to *advance the client's lawful objectives as the client defines them*… Some decisions are so vital to a client that a reasonable client would not agree to abandon irrevocably the right to make the decisions…"[96] And the decision about whether to settle is specifically reserved to the client "because a settlement definitively disposes of client rights."[97]

For the same reasons, if a funding agreement compromises the attorney's independent judgment on this, or any other, point the lawyer must withdraw.[98]

Funders' control of litigation, as illustrated above and reported in other cases,[99] erodes the foundation of the attorney-client relationship, thus understood, from one in which the lawyer loyally and zealously works to promote the client's interests to one in which the lawyer is directed to prioritize the interests of funders. As one participant in a litigation funding panel put it, this is the golden rule – he with the gold, rules. As funders become more enmeshed with law firms, not just individual cases—by incubating them, bank-rolling them, outright owning equity in them where allowed and backing portfolios originated and co-owned by lawyers where a direct ownership stake in a law firm is not allowed[100]—it is naïve to think that lawyers' loyalty remains undivided. The legal profession is at risk

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[92] *See* N.Y. Rules of Pro. Conduct Rule 1.7(a) (N.Y. State Bar Ass'n 2022) (emphasis added).; *id.* at Rule 1.8(f) ("A lawyer shall not accept compensation for representing a client, or anything of value related to the lawyer's representation of the client, from one other than the client unless… there is no interference with the lawyer's independent professional judgment or with the client-lawyer relationship."); *id.* at Rule 5.4(c) ("lawyer shall not permit a person who recommends, employs or pays the lawyer to render legal service for another to direct or regulate the lawyer's professional judgment in rendering such legal services.").

[93] *Id.* at Rule 1.17 cmt. 7.

[94] *Id.* at Rule 1.2(a-b).

[95] The Restatement (Third) of the Law Governing Lawyers § 22 (Am. L. Inst. 2000).

[96] *Id.* (emphases added).

[97] *Id.*

[98] Model Rule 1.16(a)(1) states that "a lawyer shall [...] withdraw from the representation of a client if [...] the representation will result in violation of the Rules of Professional Conduct…" Thus if litigation finance arrangements compromise a lawyer's ability, under Model Rule 2.1. to "exercise **i**ndependent professional judgment" she must withdraw (emphasis added).

[99] *See e.g. infra* [protein antitrust]; *supra* [Nimitz]; *Binh v. King & Spalding, LLP at al* and [citation].

[100] [citations].

of becoming like the medical profession – where insurers' interests constrain or even override the best interests of patients and doctors' professional judgment.[101] (Even in the medical context, it should be noted, insurers cannot compel patients to undergo medical treatment against their wishes - the analogy to allowing third-party funders to compel their clients to litigate).

Acknowledging the risk of such realignment of interests and loyalties, bar associations have repeatedly clarified that litigation funding must not run afoul of legal ethics requirements[102] including the duty to avoid conflicts of interest; the duties of loyalty and of zeal i.e., lawyers' obligation to prioritize their clients' interests and follow their clients directives, not those of funders; the duty to exercise independent professional judgment, free of funders' interference; and the duty to maintain attorney-client privilege and protect the confidentiality of 'work product'.[103] What Bar associations emphasize must be safeguarded when funding is involved implies what it is they fear is at risk: loyalty to the client, zeal in protecting the client's interests, the independent judgment of lawyers, clients' confidences and trust, and clients' autonomy.

Bar associations are aware that repeat-play relationships between lawyers and funders, in particular, are likely to breed conflicts of interest and loss of client autonomy. The *ABA's Best Practices* caution that a "lawyer should beware of conflicts of interest [for example, consider] how many times has the lawyer used the particular funder? What is the relationship between the lawyer and the funder?"[104] Conflicts may be "exacerbated by the fact that most litigation funders are repeat players, creating a perpetual cycle of investment and litigation decisions that are designed to maximize funders' return on investment rather than advance the best interests of the law firm's clients. In short, the closer the relationship between funders and law firms becomes, funders' interests will probably exert more pull than those of the clients."[105] Therefore, in the context of litigation funding, a careful lawyer will assure that the litigation funding agreement accurately reflects that the client retains control of the litigation and that the attorney "retains and protects his or her ability to exercise independent professional judgment."[106]

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[101] [citations.]

[102] *See, e.g.* ABA Comm'n on Ethics 20/20; Report on the Ethical Implications of Third-Party Litigation Funding, N.Y. State Bar Ass'n (Apr. 16, 2013) quoting in agreement Formal Opinion 2011-2: Third Party Litigation Financing, http://www.nycbar.org/index.php/ethics/ethics- opinions-local/2011-opinions/1159-formal-opinion-2011-02.

[103] Model Rules of Pro. Conduct r. 1.3 cmt. (Am. Bar Ass'n 2020) ("A lawyer must also act with commitment and dedication to the interests of the client and with zeal in advocacy upon the client's behalf."); New York Rules of Pro. Conduct, Preamble: A Lawyer's Responsibilities (N.Y. Bar Ass'n 2021) ("The touchstone of the client-lawyer relationship is the lawyer's obligation to assert *the client's position* under the rules of the adversary system, to maintain the client's confidential information except in limited circumstances, and to act with loyalty during the period of the representation.") (emphasis added); Model Rules of Pro. Conduct r. 1.7 (Am. Bar Ass'n 2020) (conflict of interests); Model Rules of Pro. Conduct r. 1.6 (Am. Bar Ass'n 2020) (confidentiality).

[104] Best Practices For Third-Party Litigation Funding 17 (Am. Bar. Ass'n 2020).

[105] Zeqing Zheng, *The Paper Chase: Fee-Splitting vs. Independent Judgment in Portfolio Litigation Financing of Commercial Litigation on Investors' ESG Demands*, 34 Geo. J. Legal Ethics 1383, 1398–99 (2021) (internal quotation marks omitted).

[106] ABA Best Practices at 11 n.5.

With respect to the question of whether freedom of contracts is the right framework, it is noteworthy that while some rules of professional conduct expressly provide that the client can give informed consent to lawyer conduct that would otherwise violate the rules, with respect to others:

> The issue of contracting around the ethics rules popped up in the 1990s, over the question of who controls the client-lawyer relationship when the client is an insured and the insurer is paying for defense counsel under a subrogation clause in the insurance contract. The relationship between insured and insurer is fraught with potential conflicts of interest. The Model Rules are clear: the lawyer's undivided loyalty goes to the client regardless of who pays. The insurance bar countered that the insurance contract can include clauses in the insurance policy to contract around these ethical prohibitions; Professors Silver and Syverud wrote a classic article defending the latter point of view. However, the ABA ethics committee disagreed, arguing that "the Rules of Professional Conduct-and not the insurance contract-govern the lawyer's obligations to the insured." The Restatement (Third) of the Law Governing Lawyers sides with the ethics committee's position. This example illustrates two points: in the law of lawyering, the fiduciary duty of undivided loyalty takes primacy over contract law, in the sense that it cannot be contracted around; but also, the Rules of Professional Conduct set the terms of that fiduciary duty. The first point helps confirm the centrality of fiduciary ethics in at least one important chunk of legal ethics: the conflict-of-interest rules. The second point helps confirm that these rules are the *lex specialis* of fiduciary obligation in legal ethics.[107]

Bar associations, however, are ineffective as regulators of litigation funding because they are generally understood to have authority over lawyers, not funders (as well as for other reasons that are beyond the scope of this paper, such as regulatory capture).[108] As discussed below, judges are much better positioned to step into the gap, and some have led the way demonstrating what effective judicial supervision can look like.

5. Defendants' Constitutional Right to Due Process.

As we have seen in the previous sections, the principle of plaintiffs' autonomy and agency over their cases is foundational, making appearance after appearance throughout the Federal Rules of Civil Procedure, the Federal Rules of Evidence, the Model Rules of Professional Conduct, and their states analogs. But wait, there's more: in the area of litigation funding generally, and the question of who should control litigation, plaintiffs' and defendants' interests actually align. When plaintiffs lose control over their cases, especially over the ability to settle them and the ability to decline to bring

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[107] David Luban, *Fiduciary Legal Ethics, Zeal, and Moral Activism.*

[108] [citations].

additional claims,[109] defendants are detrimentally affected. The loss of ability to control settlement decisions can lead to zombie litigation which is clearly detrimental to defendants who incur extra direct litigation costs as well as indirect litigation costs. A funder controlling a litigation behind the scenes, Svengali-style, can violate defendants' rights to know who, and what, they are confronted with and mount an effective defense.[110]

The direct costs of the litigation increase, first and foremost, simply because the case is prolonged– this is the essence of zombie litigation. Relatedly, lawyers often complain that when third-party funders are undisclosed, mediation fails because there is apparently a party with influence or control over settlement that is invisible to the defendants. Extra direct costs can also be the result of satellite litigation over the funder's control. Example of expensive satellite litigation in the antitrust protein litigation include the costs of the arbitration proceedings at the London Court of International Arbitration; the parallel proceedings to enforce the arbitration award and to vacate it in, respectively, NY and Illinois federal district courts; and the costs of the substitution proceedings in Minnesota and Illinois district courts and in the Seventh Circuit.

Because funders controlling litigation is alien to our legal system, it is hard to predict all of the consequent harms. For example, in the protein market antitrust litigation, an arbitral injunction against settlement led to the substitution of the funder for the original claimholder. This, in turn, led to defendants' claim of unfairness towards them in the form of having to litigate against an under- funded shell entity. The defendants claimed that any sanctions that may be ordered by the court (e.g. for discovery abuses) would not be collectable and that it would not be able to guarantee that the original plaintiffs' evidence and witnesses would be produced.[111] None of these consequences could have been foreseen by anyone at the outset. One can envision other proceedings: added discovery; standing challenges; and motions to declare and include the real party in interest.

Zombie litigation can also increase a myriad of indirect costs which often attend litigation. Such indirect costs can include harm to business relationships; distraction of and distress to employees and managers, reputational harm, depression of stock price, increase of the cost of obtaining credit

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[109] Some litigation funding agreements contain an agreement to fund an existing case and a requirement that additional claims be pursued, either as part of the pre-existing litigation or that they be brought separately. It should be noted that in some states, a requirement that claims be filed is a 'stirring up of strife' that renders an agreement champertous. In New York, for instance, the champerty statute prohibits entering into agreement "with the intent and for the purpose of bringing an action or proceeding thereon." N.Y. Jud. Law § 489(1). Entering into an agreement that required that claims not already filed be brought later could run afoul of that prohibition. See *Justinian Capital SPC v. WestLB AG* [xxx]. *See also Am. Optical Co. v. Curtiss*, 56 F.R.D. 26, 29–32 (S.D.N.Y. 1971) ("Corporations cannot maintain actions on claims which, in violation of the Penal Law, are assigned to the corporation for the purpose of bringing suit thereon."); *Bluebird Partners v. First Fid. Bank*, 94 N.Y.2d 726, 738 (2000).

[110] *See infra*, [discussion of the Nimitz case].

[111] These arguments were raised by [some of] the antitrust protein defendants in the [Minnesota substitution proceedings].

and entering into certain transactions, and more.[112] Further, if a funder controls a litigation the company's management may lose the protection of the business judgment rule.[113]

Because the type, scope, scale, and duration of such indirect costs is often uncertain and unquantifiable they create uncertainty for the parties involved. Such uncertainty is its own cost and is the bane of business.

While there is generally no incentive to bring a single non-meritorious claim, because non-meritorious claims are unlikely to lead to judgements and, therefore, they are also unlikely to lead to high-value settlements (though they may lead to low, nuisance-value settlements), bundling cases creates structural incentive to bundle 'subprime,' i.e. non-meritorious claims together with potentially meritorious ones. When funders control bundled cases, either directly or through control over lawyers, the above harms to defendants can increase exponentially. The prime example is the moral hazard created when contingency fee lawyers can shift the risk of bringing cases onto funders or secondary markets.

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In sum, the proper question isn't whether freedom of contract applies in some general sense to a contract between a funder and a (sophisticated) plaintiff, a truism in our system. The question is whether any of the exceptions to freedom of contract applies. The survey of relevant law above explains why the answer to that question is a clear 'yes.'

PART III – PREVENTING A ZOMBIE APOCALYPSE: JUDICIAL SUPERVISION AND FIDUCIARY DUTIES.

As the examples provided above indicate, notwithstanding the various norms designed to ensure plaintiffs' autonomy and prevent third-party interference with same, our system—which evolved assuming an outright ban on third-party litigation funding—is straining to deal with the new powerful market force that is third-party funding. In this Part, I first discuss what tools are currently available, but are under-utilized, by judges to prevent zombie litigation, ensure party autonomy, and more broadly prevent litigation funding-related abuses of process. I provide some examples of how a few judges used such tools in recent cases, ad hoc, to prevent funders' undue control of litigation and recommend that judges embrace and actively develop this form of managerial judging in light of the systemic effects litigation funding is having on the judicial branch. Next, I propose the imposition of fiduciary obligations on third party funders to realign interests such that everyone on the plaintiff's side of the "v."—plaintiffs, their lawyers, and their funders—will be rowing in the same direction.

A. Judicial supervision of the new aggregation device – portfolio funding.

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[112] M. Steinitz, The Case for an International Court of Civil Justice at [xx] (CUP 2019) for a full analysis of indirect costs of litigation, especially in the class and mass action contexts, and how such costs can, in certain situations, dwarf the direct costs of litigation.

[113] A presumption that officers and directors of a company act in good faith and in the best interest of the corporation and that they are therefore entitled to deference by courts. [cite]. This point was also independently made by [Dr. Limor Yehuda] in her comments at a conference in TLV University in June 2022.

In the previous sections, I explained that the issues that arise with respect to control of litigation are (1) best understood as questions of potential abuse of process; and (2) that portfolio funding is a new form of claim aggregation. In both areas—preserving the integrity of the judicial process and safeguarding the interests of plaintiffs in aggregate litigation—judges have long taken an active role. First, judges have inherent authority to ensure the integrity of the judicial process. As Judge Connolly noted in the *Nimitz* case:

> It cannot be seriously disputed that I had the inherent authority to order [the investigation.] [...] The Supreme Court has expressly held that a federal court's inherent powers include the power[] 'to conduct an independent investigation in order to determine whether [the court] has been the victim of fraud.'[114]

Second, in class and mass actions, judges have long followed a model of 'managerial judging'—active case management and a focus on both the efficiency of the process and the fairness of the settlement[115]—rather than a pure adversarial model in which lawyers alone drive the course of a case. In the class action context, to name but a few examples, judges evaluate the qualifications and experience of the proposed class counsel; identify and address any potential conflicts of interest that may arise between class counsel and the class members including assessing whether counsel has any financial incentives that could compromise their representation of the class; review and approve proposed settlements in class action cases; entertain complaints from class members who believe that their rights have been violated or that the settlement is unfair; and assess the reasonableness and fairness of attorneys' fees.[116] Judges also play an active role in mass torts, including in evaluating the fairness and adequacy of proposed settlements and the reasonableness of attorneys' fees.[117]

There are some 'green shoots' – indications that judges are starting to exercise scrutiny in the same vein with respect to ensuring that plaintiffs remain in control of their funded cases, both in aggregate litigation as well as in individual cases (i.e., irrespective of inclusion of the funded cases in a portfolio). The most straightforward way in which the courts oversee litigation finance is in granting discovery requests and entertaining parties' motions challenging the validity and/or effects of funding agreements.

More comprehensive measures of judicial supervision entail court orders, both case-specific orders and standing orders. Examples of such orders, including ones seeking to prevent funder control, are proliferating in the MDL context. Increasingly, these orders reflect an understanding that control can be indirect and implied. For example, the Northern District of Ohio, Eastern Division,

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[114] Civ. No. 21-1247-CFC) CNET MEDIA, INC.,)) Defendant.) NIMITZ TECHNOLOGIES LLC,)) Plaintiff p. 78

[115] [Source]

[116] FRCP R. 23.

[117] [citation].

has ordered that in all multidistrict litigation cases, counsel for a funded party must provide the court with:

> two sworn affirmations—one from counsel and one from the lender—that the [] financing does not: (1) create any conflict of interest for counsel, (2) undermine counsel's obligation of vigorous advocacy, (3) affect counsel's independent professional judgment, (4) give to the lender any control over litigation strategy or settlement decisions, or (5) affect party control of settlement.[118]

In Florida, a U.S. District Court in a multidistrict litigation required counsel to disclose whether the case was financed and, if so, to answer several questions including the following:

> Does the litigation funder have any control (direct or indirect, actual or apparent or implied) over the decision to file or the content of any motions or briefs, or any input into the decision to accept a settlement offer? Does the financing (1) create any conflict of interest for counsel, (2) undermine counsel's obligation of vigorous advocacy, (3) affect counsel's independent judgment, (4) give to the lender any control over litigation strategy or settlement decisions (as to either the common benefit work done by counsel or work for individual retained clients), or (5) affect party control of settlement?[119]

A similar result is achieved in some courts through the creation of local rules. In one well-known example, the U.S. District Court for the District of New Jersey amended its local rules in 2022 to require disclosure of litigation funding including an indication of the extent of the funder's control over settlement and any terms and conditions related to that control.[120]

The most involved form of judicial supervision is the role Judge Connolly played in the *Nimtz* case. Extracting from the *Nimtz* saga a model of managerial judging for the age of litigation funding, it is important to start by rendering visible the first, invisible step in Judge Connolly's supervisory role: having his antenna up and noticing possible abuses. Detecting possible violations, he ordered disclosure of the litigation finance agreements, launched a *sua suponte* investigation and issued *sua suponte* orders, conducted an evidentiary hearing, and required lawyers to make representations.[121] As a result of his findings, he referred attorneys to their bars for discipline and sent his findings to the Department of Justice for further investigation of possible fraud on the PTO based on his conclusion

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[118] *See* In re Nat'l Prescription Opiate Litig..

[119] *See In re Zantac (Ranitidine) Prods. Liab. Litig.*; Judge Connolly's Standing Order Regarding Third-Party Funding Arrangements (the Third-Party Funding Order.

[120] Rule. For a compendium of examples of local rules and standing orders related to litigation finance, *see* Shook Hardy & Bacon, Third-Party Litigation Funding: State and Federal Disclosure Rules & Case Law (May 11, 2022). Available at https://www.shb.com/-/media/files/professionals/j/katie-jackson/shb-handout-tplf-disclosure-rules-and-case-law.pdf .

[121] *See* Nimtz Techs. LLC v. Cnet Media, Inc., Civ. No. 21-1247-CFC (D. Del. Sept. 13, 2022).

that "counsel of record for the LLC plaintiffs violated numerous rules of professional conduct.[122] Of course, such extensive supervision should be reserved for rare cases with the types of red flags of serious misconduct Judge Connolly detected in his courtroom. But the case is useful in demonstrating the extent to which, with awareness of the severity of the potential effects funder intermeddling may have, judges have powerful tools at their disposal and do not need to wait for legislators to step in.

B. Fiduciary duties.

Explicit and implied throughout the judicial interventions of judges discussed throughout this paper is that judges recognize that lawyers' ability to adhere to their fiduciary (and other) duties towards clients—to act loyally, zealously, and with care—is placed under stress when a third-party funder is involved. Hence, the need for orders requiring lawyers to certify an absence of conflicts, vigorous advocacy, independent professional judgment, and absence of control—direct, indirect, explicit or implied—over litigation strategy or settlement decisions. The most straightforward way to realign lawyers' interests with their clients and restore the equilibrium that existed from time immemorial till the emergence of third party funding in the 21st century is to treat third-party funders the way that the only previously-allowed funders—i.e., contingency fees lawyers and insurance were allowed engaging in litigation funding—as fiduciaries (or, in the case of insurers under certain state laws, quasi-fiduciaries).

CONCLUSION

[]TBD]

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[122] *See* Nimtz 2022 WL 8187441, *supra* note [x].

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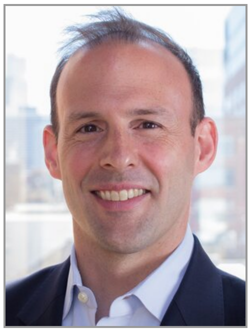
Judicial Committee Best Venue For Litigation Funding Rules

By **Stewart Ackerly** (October 28, 2024, 12:12 PM EDT)


Stewart Ackerly

On Oct. 10, the Advisory Committee on Civil Rules, which considers and recommends revisions to the Federal Rules of Civil Procedure, decided to form a subcommittee to study the issue of developing a rule to require disclosure of litigation funding in civil cases in federal district courts.

The Advisory Committee has considered litigation finance off and on since 2014, but this is the first time it has elected to study formally a potential rule requiring disclosure of litigation finance.

The Advisory Committee's decision came at the **urging** of major companies and business groups, as well as certain Republican lawmakers, that have argued litigation finance unfairly tilts the playing field against corporate defendants or otherwise harms the U.S. judicial system. They argue disclosure of funding agreements is necessary to show who has control of a case and because funding agreements should be treated like a defendant's insurance agreements, which must be disclosed pursuant to Rule 26(a)(1)(A)(iv) of the Federal Rules of Civil Procedure.

Proponents of litigation funding counter that funding helps level the playing field for litigants with meritorious disputes that otherwise lack the resources to pay lawyers the necessary amount to pursue claims in federal court. Proponents contend disclosure is unnecessary because federal courts already have the authority to inquire into financing if and when needed.

In addition, they argue, a financing agreement is unlike insurance agreements because a funder typically has no control over the litigation. Disclosing the financing agreement can also give a defendant an unfair advantage in the litigation, by revealing the plaintiff's budget for prosecuting the case.

Regardless of what side of the debate you are on about the merits or value of litigation finance, or whether and how financing should be disclosed, the Advisory Committee's decision to form a subcommittee to examine this issue is a positive development for several reasons.

First, as U.S. District Judge John Bates, who chairs the judiciary's top rulemaking panel, the Committee on Rules of Practice and Procedure, said: "We know what the theoretical problem is. I think we have to look if there are actual problems."[1] In other words, it is time to move this debate from the theoretical to the actual.

Opponents of funding often formulate hypothetical concerns about what a funder could or could not do. This committee will transform the debate into one based on actual practice, experience, and data about how funding works and its effect in real world cases. A proper understanding of funding is essential to understanding what issues disclosure may solve, what issues disclosure may create, and what exactly should or should not be disclosed.

Second, there is no group better suited to study this issue than the Advisory Committee. Comprising leading jurists, practitioners and academics, the Advisory Committee understands the complexities of litigation finance and disclosure, and the need for careful and extensive analysis of this issue. The Advisory Committee noted in its Meeting Book for the October 2024 meeting that this will "likely be a challenging project," and that "[m]uch education will be needed to gain a reliable familiarity with the issues involved."[2]

Although disclosure of litigation funding is often portrayed as a simple issue, there are myriad complex issues and decisions involved. These include definitional issues, several of which the Advisory Committee noted. According to the Meeting Book notes, beyond the foundational question of whether disclosure should be required at all, there is the subsequent "challenge to describe in a rule when the disclosure requirement applies," or, in other words, "what is or is not the sort of litigation funding that must be disclosed"?[3]

What if a plaintiff's family member provides financing for a dispute? What if a plaintiff accepts financing for working capital during the pendency of a dispute? What if a nonprofit is financing a legal dispute? If the plaintiff's lawyer is financing the case — i.e., taking the case on contingency — should that be disclosed? Also — in what is becoming a more frequent scenario — what if the law firm is receiving financing tied to a case, but the client is not? Does the law firm's financing necessitate disclosure?

Other questions will also arise for the subcommittee to consider. For example, there is a stark difference between consumer litigation finance — which focuses on personal injury and medical malpractice claims — and commercial litigation finance — which focuses on business-to-business or other complex commercial disputes. Are the objectives of disclosure the same for both types of financing? And what about mass torts or other collective actions, that involve entirely separate and distinct issues?

The Advisory Committee, with decades of experience in rulemaking and litigating, is well positioned to analyze carefully these issues, consider input from all stakeholders, and take a balanced, deliberative approach to the issue.

Third, the Advisory Committee will take the necessary time to consider the disclosure issue thoughtfully and exhaustively. To date, the disclosure issue has more closely resembled a game of Whac-a-Mole. Litigation finance disclosure bills are proposed in state legislatures around the country every year. Litigation finance proponents then try to beat back those proposals as overbroad, ill-conceived or unnecessary. None of this leads to reasoned debate. Instead, it has politicized the issue and made it more difficult to engage in clear-eyed decision-making about the best path forward.

The Advisory Committee will take the time it needs to study the issue and evaluate potential options. If the Advisory Committee proposes a rule — which may be a big "if," given the complexity of the issue and the powers courts currently have to address the issue — it will ensure any rule is narrowly tailored and carefully calibrated to ensure fairness to all parties.

Helpfully, while the Advisory Committee considers this issue, courts will continue serving as mini-laboratories for how to deal with funding. Examples include the U.S. District Court for the District of New Jersey's limited disclosure requirement, and a September decision from the U.S. District Court for the District of Delaware denying Target's effort to compel production of documents from a funder because the requested documents were protected Attorney Work Product or production "would impose a burden disproportionate to their value."[4] These decisions and efforts will only help inform the Advisory Committee's work.

Fourth, the Advisory Committee's decision will hopefully encourage lawmakers to hit pause on efforts to legislate on this issue. The Advisory Committee provides a neutral setting for study of the disclosure issue, potential options and any recommendations — whether that is maintaining the status quo or amending the Federal Rules. Hopefully those on both sides of this debate can agree to remove the disclosure question from the politicized halls of Congress and state houses, and give time for the experts to weigh in on this important issue.

The Advisory Committee has a history of examining politically charged issues with a balanced, thorough approach that gives all stakeholders an opportunity to participate. For example, the Advisory Committee recently studied issues surrounding potential rules specific to multidistrict litigation — a highly charged issue for the plaintiffs and defendants bars. This history demonstrates the Advisory Committee's superiority as a venue to consider challenging issues and produce results that provide for balanced and fair rules governing civil litigation in federal courts.

The ultimate result of the subcommittee's work is anyone's guess. It may conclude that courts have ample existing authority to explore financing if and when that's necessary. Alternatively, it may conclude that a rule requiring limited disclosure adequately addresses any issues that the subcommittee's work identifies.

Regardless, this exercise will help all participants in the legal system — plaintiffs, defendants, lawyers, judges, court staff, funders and policymakers — better appreciate the role of funding. More importantly, this exercise should help ensure that the ultimate result, whatever that is, is the product of a thorough, inclusive and deliberative process that appropriately balances the interests of all those involved.

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[1] See https://www.reuters.com/legal/government/us-judicial-panel-examine-litigation-finance-disclosure-2024-10-10/.

[2] Advisory Committee on Civil Rules, Meeting Book at 419 (October 10, 2024) available at https://www.uscourts.gov/sites/default/files/2024-10_civil_rules_agenda_book_final_9-20_at_230_pm.pdf.

[3] Id. at 418.

[4] Design with Friends Inc. et al. v. Target Corporation, No. 1:21-cv-01376, Memorandum Opinion at 7 (Sept. 27, 2024) (ECF No. 417).

Tab B

Taskforce for Responsible AI in the Law

Interim Report to the State Bar of Texas Board of Directors

Introduction

In 2023, under the leadership of State Bar President Cindy Tisdale, the Taskforce for Responsible AI in the Law (TRAIL) was formed to address the growing impact of Artificial Intelligence (AI) in the legal profession. The taskforce has worked to identify ways that the emergence of new AI technology might affect the practice of law and how lawyers, judges, and the State Bar should respond. The work of TRAIL focuses on crafting guidelines, navigating challenges, and embracing the potential of AI within the legal profession.

This interim report represents an initial step in understanding the integration of AI within the legal profession. It highlights the taskforce's progress and ongoing efforts, underlining the complexity and scope of the work still required. This document serves as a marker of our current understanding and the groundwork laid, pointing towards a comprehensive and more detailed final report. The emphasis is on continued research, collaboration, and thoughtful development in this rapidly evolving landscape. Regulation and technology will both continue to evolve over the course of this work. None of the preliminary thoughts described below should be taken as any formal recommendation, but rather reflect preliminary concepts being considered by the taskforce.

Executive Summary

The TRAIL Interim Report includes a variety of recommendations being considered across different areas of legal practice, with a focus on the ethical and practical integration of AI. These proposals, while still under review and not finalized, cover:

1) **Cybersecurity**: encouraging awareness among lawyers about possible risks associated with using AI tools, including third party access to sensitive information
2) **Education and Legal Practice**: recommending the inclusion of AI topics in professional education for both lawyers and judges and proposing targeting or increasing attorney's continuing legal education (CLE) hours to include AI and technology issues germane to the practice of law
3) **Legislative, Regulatory, and Legal Considerations**: suggesting the review and monitoring of legislation, regulation, and case law relevant to AI in legal practice, and considering the development of AI-focused legislative proposals
4) **Ethical and Responsible Use Guidelines**: developing recommendations regarding generative AI use that address compliance with attorney ethics and advertising regulations, and offering guidance on the ethical use of AI in legal practice
5) **Access and Equity**: proposing support for legal aid providers in accessing AI technology and potential technologies to enhance individual access to the justice system
6) **Privacy and Data Protection**: examining the implications of privacy laws on AI and proposing best practices for handling personal data in AI applications
7) **AI Summits and Collaborative Efforts**: suggesting the organization of AI summits for knowledge sharing and collaboration among stakeholders

Mission Statement

The Taskforce for Responsible AI in the Law is focused on educating Texas practitioners and judges about the benefits and risks of AI and fostering the ethical integration of AI within the legal profession. The mission of the taskforce is to explore the uncharted frontiers of AI in the legal profession, approaching this new world with caution and optimism and ensuring that technology serves the legal community and the public without compromising the values central to our profession. The taskforce will investigate how legal practitioners can leverage AI responsibly to enhance equitable delivery of legal representation in Texas while upholding the integrity of the legal system, and the taskforce will make recommendations to the State Bar's Board of Directors consistent with this goal.

Vision Statement

The taskforce envisions a future where the integration of AI in the legal profession is both innovative and principled. Striving to lead the way in Texas and beyond, our focus is on crafting standards and guidelines that enhance legal practice through AI, without sacrificing the core values of justice, fairness, and trust. In this bold new era, we will lead with care and optimism, ensuring that the transformative power of AI serves the legal community and the public with excellence and integrity.

Purpose of the Report

This report serves as an interim report to the Board of Directors concerning the work of the Taskforce for Responsible AI in the Law, its preliminary findings, recommendations that are under consideration, and proposed future activities of the taskforce.

Scope and Limitations

The material outlined in this interim report are preliminary thoughts, many of which will require additional investigation. The potential recommendations listed are currently under review and consideration by the taskforce and are reported here to give the board an opportunity to consider the possible recommendations and provide the taskforce with feedback and direction for its work. The topic of AI has attracted the attention of the media, academia, and government. It is a broad issue with implications for almost every facet of society. The taskforce's attention, however, is limited to consideration of the ramifications of AI for the practice of law.

Subcommittee Insights

The taskforce began its work by identifying issues in the legal profession that may be affected by AI. A subcommittee was assigned to each issue. The initial reports from the subcommittees are included as appendices to this report, and what follows is a summary of the issues identified by each subcommittee and the tentative recommendations that may be proposed at a later date for action by the State Bar of Texas or by other stakeholders in the legal sphere. These tentative recommendations are only proposals at this stage; the Taskforce has not reached a consensus on these proposals and is not asking the State Bar Board to take any action at this time.

Cybersecurity

Overview of the Issues

All lawyers and clients rely on information technology, the Internet, and cloud computing, which means that we all face exposure to cybercrime. Cybercriminals could use AI to be disruptive, spread malware, spread disinformation, and commit fraud and theft, but AI can also be a tool to help lawyers and clients predict or protect against cybercriminals' behavior in the future.

Potential Recommendations

The State Bar should help lawyers become more aware of the risks associated with cybercriminals and in particular the use of AI to hide cybercriminal behavior. The State Bar may wish to consider:

1) including cybersecurity and AI training in CLE events for all lawyers
2) creating an AI toolkit on the State Bar's website
3) publishing articles on cybersecurity threats to lawyers and law firms in the State Bar Journal and section publications

The State Bar should team up with the Chief Information Security Officer (CISO) community to learn more about their perspective on cybercriminals' use of AI.

Cybersecurity Concerns

Here are specific AI cybersecurity concerns that should be addressed:

Malware	Malware is software designed to disrupt, damage, or gain access to a computer system. Often employees unwittingly fall victim to email phishing attacks allowing in disruptive malware. Regular cybersecurity training of employees to prevent them from falling for email phishing attacks is recommended since cybercriminals use AI to fool individuals into opening or responding to fake emails.
Business Email Compromise ("BEC" or "Spearphishing")	When a cybercriminal sends an email or phone call posing as the CEO and requests that the CFO wire monies to a bank is an example of BEC. Cybercriminals are using AI regularly to hide their behavior, including using generative AI tools to replicate the voice of an executive to further their criminal act. Regular cybersecurity awareness training is also recommended.

Privacy

Overview of the Issues

How Does Privacy Law Apply to AI?

Privacy laws apply broadly to protect personal data, and AI is no exception. U.S. state consumer privacy laws and sectoral privacy laws may apply based on the involvement of personal data in any component of AI. International privacy laws applicable to many U.S.-based companies, by nature of the company processing international personal data, could also apply to AI. Notably, proposed legislation to regulate AI has acknowledged the application of privacy laws.

Where Is Personal Data in AI?

Personal data can be found in the data sets used to train AI. Personal data can also be input into an AI tool (e.g., submitting personal data in a prompt to ChatGPT). AI can also be used to make recommendations or inferences that affect privacy.

Potential Recommendations

The AI and Privacy Committee will continue its study of how privacy laws apply to AI and consider any specific implications for Texas lawyers in order to provide pragmatic recommendations to the Texas Bar. Contingent upon the committee's work, the taskforce may consider recommendations regarding the following:

1) how to identify when AI uses personal data
2) best practices for protecting personal data involved in AI

Ethics and Responsible Use

Overview of the Issues

The use of AI in the legal profession raises ethical issues that will need to be addressed by the legal profession.

Ethical Lapses and Misuse of Generative AI

Early instances of lawyers using generative AI in drafting have exposed the potential for ethical lapses due to the misuse of generative AI. Notable instances include:

1) In *Mata v. Avianca Airlines* lawyers submitted a brief with fabricated judicial decisions, leading to sanctions.
2) In *Ex Parte Lee*, a lawyer used a generative AI tool that created nonexistent case citations.
3) A Colorado lawyer was suspended for using fictitious cases from ChatGPT in a legal motion.
4) A Los Angeles law firm was sanctioned for using ChatGPT to draft briefs that included fabricated cases.

Risk of Ineffective Assistance of Counsel

There's a concern about the quality of legal representation, as evidenced by a case in Washington, D.C., where a defendant cited ineffective assistance due to their attorney using generative AI for a closing argument without disclosing financial ties to the AI's developer.

Violation of Ethical and Professional Conduct Rules

Texas lawyers face the risk of violating various disciplinary rules, including:

1) Rule 1.01 on providing competent representation
2) rules related to diligence, candor to the tribunal, supervision of work, and protecting client confidentiality
3) potential violation of Rule 1.05 regarding safeguarding client information, especially when using confidential data in AI prompts in unsecure environments
4) ethical considerations in charging reasonable fees for services enhanced by generative AI tools

Need for Ethical Guidance and Oversight

Ethical guidance and oversight are needed regarding the use of generative AI in legal practices. This includes publishing ethics opinions that address appropriate generative AI use and establish what constitutes reasonable fees and costs in relation to AI use and compliance with ethics and advertising regulations.

Recommendations from Other State Bar Associations

Various bar associations, including those in Florida and California, are proposing guidelines for lawyers using generative AI. These guidelines emphasize the need for lawyers to:

1) protect client confidentiality
2) provide diligent and competent representation
3) supervise both lawyers and nonlawyers in their use of AI
4) communicate adequately with clients about AI use
5) ensure compliance with relevant laws, including intellectual property law

Potential Recommendations

1) Consider having the State Bar of Texas (SBOT) Mandatory Continuing Legal Education (MCLE) Committee promulgate a change to the existing MCLE requirements, making it mandatory that 1.0 hour of an attorney's annual MCLE requirement be in technology.
2) Consider requesting that the Professional Ethics Committee of the State Bar of Texas prepare and issue an ethics opinion providing guidance to Texas practitioners on the ethical dimensions of use of generative AI. This might echo the subjects addressed by the Florida and California ethics proposals discussed in this report. In addition, such an opinion might be along the lines of the Professional Ethics Committee's Ethics Opinion 680 in 2018, which addressed attorneys' use of cloud computing technology, and which addressed multiple ethics concerns.
3) Consider requesting that Texas Bar CLE include that, for at least the next year, one of the subjects at any Texas Bar CLE program be in the area of generative AI use.
4) Consider recommending to the Texas Center for the Judiciary that an educational program on generative AI and its ethical dimensions be added to the center's course offerings for Texas judges. This would provide trial and appellate judges with necessary education on attorney use of generative AI and assist in consideration of potential measures for judicial oversight.
5) Consider recommending to the Supreme Court of Texas Rules Committee that it explore Texas Rules of Civil Procedure 13 on the Effect of Signing Pleadings, Motions, and Other Papers and evaluate whether additional language or guidance is necessary to provide Texas lawyers with additional information regarding AI-generated misinformation or hallucinations, as well as to provide Texas judges with adequate remedies regarding same.
6) Consider increasing Texas lawyers' awareness of the benefits and risks of generative AI by increasing the number of CLE offerings and publications regarding this subject. For example, this might include a special issue of the Texas Bar Journal exploring topics related to generative AI.
7) Consider recommending that the State Bar of Texas explore, with one or more AI vendors, a working relationship that would result in a benefit for use by Texas member lawyers. This might, for example, involve discounted access to AI tools, along the lines of the State Bar's previous relationship with Fastcase for legal research.
8) Consider recommending that the State Bar of Texas hold an annual or semi-annual "AI Summit," at which stakeholders from multiple State Bar-affiliated entities could gather to learn about generative AI and share best practices regarding its use. Such an event might also involve

reviewing the work of other state bars and/or other AI taskforces around the country and sharing information regarding the same.

Judiciary

Overview of the Issues

The use of AI in the courts raises ethical and practical issues that should be addressed. These issues include the following.

Standing Orders Prohibiting Litigants from Using GenAI tools Is Not Generally Helpful

Because some attorneys have submitted briefs that contain nonexistent cases, some courts have been entering standing orders that require parties to certify whether any generative AI tool has been used and that all arguments, cited cases and exhibits have been reviewed by a human prior to filing. Because many legal research tools will (or already do) incorporate generative AI into their product, these standing orders may result in litigants disclosing their use of Westlaw, Lexis, Grammarly, etc. This is likely an unhelpful feature, and courts already have the ability to appropriately sanction an attorney for filing a motion or brief that contains false statements. It may also discourage the development and adoption of tools that, used properly, could enhance legal services.

Use of Generative AI Tools by Judges, Law Clerks, and Court Staff

The Texas Code of Judicial Conduct is written using broad language. Arguably, a judge relying solely on an AI tool with no subsequent verification would violate Canon 1 of the Texas Code of Judicial Conduct (upholding the integrity and independence of the judiciary).

AI tools may be helpful in drafting rough drafts of any order, but it is advisable that generative AI tools that have been developed for legal use be utilized, rather than generic generative AI tools that may be developed with nonlegal related material and may not be updated regularly with recent cases and statutes.

Confidentiality and Privacy Concerns

If the decision is made to use a nonlegal developed generative AI tool, caution should be exercised to ensure that only public information is entered and that no sealed, personal health information, or sensitive personally identifiable information is inserted into any prompt.

Security Concerns

As with all software or apps that are installed onto court-issued computers, tablets or other devices, it is recommended that any generative AI tools be vetted prior to use. The terms of service of any generative AI tool should be reviewed for industry standard commitments to quality and relevant representations and warranties, including to determine what, if anything, is done with prompts or documents ingested into the tool. How was the tool validated for accuracy and completeness? Are the prompts or documents used to further train the AI tool? Upon the matter's conclusion, how are the prompt histories or documents ingested into the system deleted? What representations are made regarding the AI developer’s cybersecurity measures?

Training

Judges should make law clerks and staff aware of what, if any, acceptable use of generative AI tools the judge authorizes. If the judge allows law clerks and staff to use appropriate legal-based generative AI tools, judges and court personnel should be trained on how to use the tool (i.e., how to adequately create prompts).

Evidentiary Issues

An immediate evidentiary concern emerges from "deepfakes." Using certain AI platforms, one can alter existing audio or video. Generally, the media is altered to give the appearance that an individual said or did something they did not. The technology has been improving rapidly.

What is more, even in cases that do not involve fake videos, the very existence of deepfakes will complicate the task of authenticating real evidence. The opponent of an authentic video may allege that it is a deepfake in order to try to exclude it from evidence or at least sow doubt in the jury's minds. Eventually, courts may see a "reverse CSI effect" among jurors. In the age of deepfakes, jurors may start expecting the proponent of a video to use sophisticated technology to prove to their satisfaction that the video is not fake. More broadly, if juries—entrusted with the crucial role of finders of fact—start to doubt that it is possible to know what is real, their skepticism could undermine the justice system as a whole.

Although technology is now being created to detect deepfakes (with varying degrees of accuracy), and government regulation and consumer warnings may help, no doubt if evidence is challenged as a deepfake, significant costs will be expended in proving or disproving the authenticity of the exhibit through expert testimony.

In cases where a party challenges an exhibit as a deepfake or not authentic, judges should consider holding a pretrial hearing to consider the parties' arguments and any expert testimony.

Pro Se Litigants and Generative AI

While there has already been substantial publicity about inaccurate ChatGPT outputs and why attorneys must always verify any draft generated by any AI platform, the bench must also consider the impact of the technology on pro se litigants who use the technology to draft and file motions and briefs. No doubt pro se litigants have turned to forms and unreliable internet material for their past filings, but ChatGPT and other such platforms may give pro se litigants unmerited confidence in the strength of their filings and cases, create an increased drain on system resources related to false information and nonexistent citations, and result in an increased volume of litigation filings that courts may be unprepared to handle.

Potential Recommendations

1) As nonlawyers, pro se litigants are not subject to the Rules of Professional Conduct, but they remain subject to Tex. R. Civ. P. 13. The current version of Rule 13, however, requires that the pro se litigant arguably know, in advance of the filing of a motion, that the pleading is groundless and false. The Texas Supreme Court Rules Advisory Committee may wish to consider whether Rule 13 should be modified.
2) Consider recommending that the State Bar post information for the public on its website about the responsible use of AI by pro se litigants.
3) Consider developing a list of "best practices" for the use of AI in the courts.
4) Consider developing or providing verified tools to guide constructive use of generative AI for pro se litigants.

Governance

Overview

The governance of AI entails rules and standards surrounding the responsible development and use of AI, and the enforcement of such rules. Industry leaders have acknowledged that AI governance or regulation is important and necessary to protect the public. AI governance also includes “soft law” principles that should be used for the development of technology used for the provision of legal services, in courts, or to increase access to justice.

Current State of AI Governance Initiatives

Since 2022, there has been proposed legislation to regulate the use of AI in numerous jurisdictions across the world. Certain trends in the proposed legislation have arisen.

Defining AI

Some of the proposed definitions of AI attempt to focus on generative AI and large language models. There is concern over definitions that are too broad and include common technology like the calculator or that, conversely, are too narrow and could be outdated before the law goes into effect. For example, older types of AI, such as machine learning, can also present risk in legal practice.

High Risk Use of AI

Proposed legislation tends to focus on a risk-based approach where a high-risk use of AI would result in legally significant or similar effects on the provision or denial of (or access to) employment, education, housing, financial or healthcare services, and other significant goods, services, and rights. Variations of the term “legally significant or similar effects” have spread from the E.U. to the U.S. and appear to be a likely standard of measuring the effects of decisions by AI. Whether humans are involved in the decision making also impacts the level of risk. Governance of AI often turns on separating low, medium, and high-risk use cases and applying rules fit to risk level.

Transparency

Proposed legislation in the U.S. and in other countries often seeks to incorporate obligations on deployers and/or developers to make public disclosures of the training data, personal information collected, decision-making process, and impact of the AI output. Competing concerns include intellectual property rights of developers and deployers.

Assessments

Higher risk uses of AI can trigger obligations to conduct and document risk assessments and pre- and post-launch impact testing. In some high-risk cases, red teaming (adversarial testing) of generative AI may become a standard for developers or potentially deployers.

Other Law

Proposed legislation does not purport to override other existing laws like HIPAA, COPPA, consumer privacy, confidentiality, etc.

Issues for Consideration

It is currently unknown what exactly will be required of lawyers and law firms who utilize AI tools. For example, an assessment of high-risk uses of AI and disclosure of AI-based decisions may be required based on proposed legislation.

It is possible that many attorneys and/or law firms could qualify as a deployer of AI, and the use of AI without meeting the prerequisites imposed by statutory obligations such as making appropriate disclosures and conducting a risk assessment could result in a risk of financial and reputational harm.

Potential Recommendations

The AI and Governance Subcommittee will continue studying any proposed AI legislation and other AI governance initiatives to develop pragmatic recommendations to the Texas Bar. The subcommittee will also consider principles and norms that should guide the development of legal AI tools. Contingent upon this committee's work, the taskforce may consider recommendations regarding the following:

1) the tracking and monitoring of legislation and governmental agency regulations for potential publication to Texas attorneys, so that they can use AI in accordance with legal obligations
2) identification of governance trends and the possible consideration of AI-focused legislative proposals in Texas
3) methods for creating and evaluating values and norms for the use of AI in legal technology, including tools to help ensure that results generated by AI tools are valid and unbiased
4) using information gathered in monitoring trends and legislation, provide a sample template allowing attorneys and law firms to evaluate and/or document their use of AI

Employment Law

Overview

Whether you are a Texas lawyer representing Texas employees or Texas employers, or a lawyer litigating on behalf of or against national employers operating in Texas, it is critical to be aware of the many ways in which AI is impacting the modern workplace. Use of AI within law firms for employment or HR purposes can also raise risks and obligations.

Widespread Use of AI in Employment Practices

AI tools are being extensively used by businesses for screening job applicants. AI is also employed in various aspects of human resource management, including recruitment, hiring, training, retention, and evaluating employee performance.

Potential Bias and Discrimination

Despite the potential to eliminate bias, current AI applications might inadvertently perpetuate existing biases, leading to unintentional discrimination. Examples include:

1) AI tools rejecting applicants with resume gaps, potentially discriminating against individuals with disabilities or those who took parental leave
2) overlooking older workers due to smaller digital footprints on social media and professional platforms

Legislative Responses to AI in Employment

There's an increasing trend in city and state legislatures to introduce AI-focused bills. Notable examples include:

1) California's draft AI regulation and legislative proposals to regulate AI's use in employment
2) New York City's Local Law 144 requiring bias audits for automated employment decision tools
3) proposals in other states like Illinois and Vermont focusing on regulating AI in employment decisions and employee monitoring
4) At the federal level, there are proposals like the Artificial Intelligence Research, Innovation, and Accountability Act of 2023 (AIRIA) and the Algorithmic Justice and Online Platform Transparency Act aimed at regulating discriminatory algorithms and allowing government intervention against AI-induced discrimination.

Potential Recommendations

This committee will continue to study what developments may occur in this area. Potential recommendations that the taskforce may later recommend include:

1) advising the Labor and Employment Section to list all legislation and regulations that practitioners in this area should be aware of
2) inasmuch as lawyers are employers as well, recommending that the State Bar publish a listing of legislation and regulations in this area

Family Law

Overview

Texas family law attorneys tend to be early adopters of technology. Family law is a fast-paced field with a high volume of cases, demanding a high level of professional efficiency.

Digital Evidence in Family Law

With over 85% of Americans using smartphones, digital media such as audio recordings, emails, texts, social media posts, and GPS data have become ubiquitous in family law cases. The handling of these extensive and voluminous personal records is a critical aspect of family law practice.

Misuse of Digital Data

Given the emotionally charged nature of family law and the inherent lack of trust between parties, there's a notable issue with the misuse of digital data.

AI's Role in Enhancing Efficiency

AI has the potential to significantly enhance efficiency in family law, similar to past technological advancements like fax machines, scanners, email, and eFiling. However, AI differs in its autonomy, operating without skilled oversight and ethical constraints, and producing sophisticated results.

Use of AI by Self-Represented Litigants

A majority of Texas family law cases involve litigants without legal counsel. Many of these self-represented litigants turn to free online AI solutions to compensate for their lack of legal knowledge.

Legal Aid and AI

Legal aid associations are developing AI avatars to assist clients with inquiries and court preparation.

AI's Potential for Family Law Cases

Family law attorneys should consider utilizing AI to streamline document management, increase efficiency, and enhance communication with clients, while safeguarding courts against potential misuse and avoiding ethical entanglements.

There are many potential benefits of incorporation of AI systems for family law attorneys:

1) **Discovery**: AI document management systems can be used to streamline discovery by proposing and narrowing relevant discovery requests and objections. Voluminous documents can be sorted and scanned to identify responsive records and flag privileged communications that might otherwise escape detection. These systems can eliminate duplication, identify frivolous, repetitious, and bad faith responses, objections, and nonanswers, and then draft requests for sanctions or to compel.
2) **Document Management**: AI systems can independently evaluate records, categorizing them and organizing them by content. These systems can summarize the records as a whole or by category, no matter how voluminous, and then retrieve certain records based on natural language descriptors. Rule of Evidence 1006 summaries can be easily generated and readied for submission in court in lieu of offering separate and numerous exhibits.
3) **Contracts**: AI systems can draft, review, compare, and summarize contracts and drafts, to facilitate the creation of pre- and post-nuptial agreements, AID's, and other settlement agreements.
4) **Improved Communications**: Client hand-holding consumes a significant amount of time for lawyers and staff, particularly in solo and small firms. Online chatbots and virtual assistants can provide simple answers to common client questions, easing the administrative burden on staff, increasing efficiency, and eliminating wasted billable hours. Witness prep for depositions and trial can be bolstered or even replaced with AI training. This is particularly useful for self-represented litigants who have no other source of guidance. Legal Aid services are already implementing online training bots for clients and low income nonclients alike which may soon be made freely available to the general public.
5) **Trial Preparation**: By analyzing strengths and weaknesses of claims, AI systems can identify evidentiary gaps and recommend additional discovery requests, responses, and necessary witnesses. These systems can recommend and create demonstrative exhibits that appeal to certain judges or jurors. Trial briefs can be generated during contested hearings for submission during closing argument. Postjudgment motions can be generated from analysis of transcripts, for use as motions for new trial and polished appellate briefs.
6) **Tracing**: Successful tracing of separate property requires meticulous record keeping and clear presentation of complex concepts. AI can apply and compare various tracing methods and identify potential gaps that could be fatal to a tracing analysis. It can prepare timelines and summaries to bolster the presentation, possibly eliminating the need for expert testimony in some tracing cases.
7) **Social Media**: There is rarely a family law hearing that does not involve social media evidence. Unfortunately, there are many social media platforms, and search features are generally inadequate for sweeping and thorough inspection. AI can continually scan and monitor social

media for useful information about parties or witnesses, or posts indicating bias of potential jurors. This would be of great value in presenting motions to transfer venue under TRCP 257.

Potential Risks

While the potential benefits are numerous, so too are the risks of misuse and abuse. Family law lawyers must be able to anticipate, identify, and respond to these situations.

1) **Falsified Records**: Free AI websites can easily create fake, manipulated, forged, and pseudo documents and records that frequently escape detection. Government records (passports, driver's licenses, search warrants, protective orders, deportation orders) and personal records (medical, drug tests, utility bills, real estate documents, bank statements) can be obtained in seconds, for a minimal cost. Fake emails, texts, audio recordings, and social media posts may be indistinguishable to a nonexpert without application of AI detecting software.
2) **Medical Lay Opinions**: Parental observation and opinion of their child's medical, mental and emotional condition is commonly admitted in family law hearings. The basis for these opinions is explored on voir dire or during cross examination to test the credibility of the parent's testimony. Parents often report relying on input from the children's treating physicians. However, as AI chatbots replace personal interactions with medical professionals, opinions based on doctor's recommendations may be deemed unreliable. This is exacerbated by the recent trend of AI systems being quietly trained by unsophisticated workers to anthropomorphize communications—emoting to show seemingly real empathy and thus soothe frightened patients. Mimicry of empathy and humanity by AI can manipulate human emotion and sway outcomes in imperceptible ways.
3) **Editing of Digital Media**: "Deep fakes" are fictitious digital images and videos. They are created with simple, free apps currently available on both Apple and Android smart phones. With a few clicks or taps, AI can manipulate digital media and create seemingly authentic photos and videos that easily fool unwary recipients. AI detectors flag suspicious files, but they are not foolproof. Attorneys should routinely run all digital photos through AI detectors.
4) **Caller ID spoofing**: Spoofing is the falsification of information transmitted to a recipient phone's display that disguises the identity of the caller. The technique enables the user to impersonate others by changing the incoming phone number shown on the receiving phone. In this way, someone can fabricate abusive, repeated, or harassing calls and texts seemingly originating from one spouse, parent, paramour, child, law enforcement or CPS. The perpetrator can create a mountain of false evidence while hiding behind AI anonymity. AI systems can be instructed to inundate a recipient with nonstop harassing messages or calls, without leaving any digital footprint on the perpetrator's phone or computer. By evaluating years of messages and emails, the AI system can mimic the victim's speech and emoji patterns—a key element of admissibility. Further, AI spoofers can be used to fraudulently obtain or circumvent liability for life-long protective orders under Tex. Code Crim. Pro. 7b for stalking by digital harassment. And because these systems do not work through the service provider, third-party discovery from the phone company will appear to confirm that the calls or messages originated from the spoofed number, lending an air of credibility to the ruse.
5) **Voice Cloning**: Voice cloning apps and websites allow someone to convincingly spoof the voice of any other person with only a single audio sample of the target. Someone with dozens of voicemails and recorded conversations from years of marriage, or even a recorded deposition, can use these systems to create audio files that require an AI detector or forensic expert to detect.

6) **Data Analysis Manipulation**: AI systems can be used to subtly modify large data sets, corrupt legitimate data analysis, and generate false conclusions that appear legitimate and are only detectable by competing expert review. They can fabricate peer review and approval, circumventing the rigorous gatekeeping process that would otherwise be required for admissibility. This allows lay witnesses to present false opinions as verified scientific fact, or as the basis for a law-expert opinion.
7) **Dissemination of Misinformation**: As described above, AI can monitor and find useful social media evidence. However, it can also wield the power of social media to maliciously generate false information and evidence. AI can be unleashed to wage a social media disinformation campaign. It can flood various platforms in a reputation manipulation campaign targeting the judge, opposing counsel, parties, or witnesses. It can untraceably tamper with or poison a jury pool, spreading lies or false legal positions and authority. It can significantly damage the reputation of court participants, enabling the other side to provide negative reputation testimony to undermine the credibility of opposing witnesses. And these efforts could create sufficient taint to legitimately support a motion to recuse or venue transfer motion under TRCP 257.
8) **Facilitated Hacking**: Hackers use AI systems to breach secure cloud databases and obtain unauthorized access to sensitive personal information. Client's financial, medical, or personal communications, including attorney-client privileged emails, could be surreptitiously obtained. Moreover, hackers can target law firms seeking to break into their secure servers, obtaining access to all privileged records and client files. Lawyers should question the source of such information, so as not to run afoul of criminal prohibitions on use of stolen digital data, such as the Texas Penal Code 16.04. Additionally, these systems can hack dating apps and target unwary spouses for romantic entrapment using AI chatbot baiting.
9) **Voluminous Records**: One of the great benefits of AI is the handling of voluminous records: thousands of documents, millions of emails, or decades of bank statements and canceled checks. Through AI analysis, there is the possibility that all could be categorized and summarized, potentially one day without human oversight. However, there remain important questions about the validation of such tools and the ongoing role of human oversight. The committee will explore how to address risks presented by greater use of this technology.
10) **Local Rules and Court Practices**: AI systems can analyze a court participant's public life and social media presence, seeking leverage for inappropriate strong-arming and manipulation. In a similar way, the systems can be unleashed on a judge's personal and professional history, determining personal predilections, biases, and likely outcomes. The old saying, "A good lawyer knows the law. A great lawyer knows the judge," takes on new meaning when the knowledge includes a detailed and thorough psychological and historical evaluation of the judge.

Potential Recommendations

1) Increase Texas lawyers' awareness of the benefits and risks of AI by expanding the number of CLEs and articles regarding same.
2) Consider 1 hour of MCLE per year requirement to meet the technical competency and proficiency requirements of Texas Disciplinary Rules of Professional Conduct, Rule 1.01 Comment 8.
3) Examine and review TRCP 13 Effect of Signing Pleadings, Motions, and Other Papers: Sanctions to ensure that trial and appellate courts have adequate remedies regarding AI- generated misinformation or hallucinations.
4) Increase and support AI integration for low-income and pro bono legal service providers.

5) Annually review AI and its utilization and risk for Texas lawyers.
6) Continually review other State Bar and national legal organizations' reviews and recommendations regarding AI and the legal profession.
7) Periodically review state and federal laws regarding AI and advise Texas lawyers of any changes that would or could affect the practice of law.
8) Ensure that Texas judges are routinely provided with current information regarding the benefits and risks of AI.
9) Begin exploring with AI vendors a working relationship for potential use by Texas lawyers, similar to the State Bar's access to Fastcase.
10) Update predicate manuals to have enhanced materials and examples for offering or challenging digital evidence.

Healthcare

Overview

Complex Regulation of Medical AI

The U.S. Food and Drug Administration (FDA), U.S. Department of Health and Human Services (HHS), Centers for Medicare and Medicaid Services (CMS), state medical boards and others have overlapping and complementary jurisdiction over AI in healthcare and life sciences. The use of AI in healthcare raises important opportunities for new treatments, improved medical decision making, and access to care and defragmentation of the healthcare system. At the same time, AI in healthcare poses unique risks and challenges to existing regulatory and legal rules such as the learned intermediary and the distinction between devices and practicing medicine. Lawyers in this space will face uncharted territory as the technology evolves.

Dependence on IT, the Internet, and Cloud Computing

Healthcare providers heavily rely on information technology, the Internet, and cloud computing, necessitating the protection of patient data privacy, especially when AI is involved.

HIPAA Compliance and Patient Data Protection

Healthcare providers are bound by the Health Insurance Portability and Accountability Act (HIPAA) to protect patient health information (PHI). They use Electronic Health Record (EHR) systems, such as EPIC and Cerner, where AI is likely utilized to assist healthcare providers and business associates.

Third-Party Software and AI Risks

Given the reliance on cloud computing, it's probable that third-party Software-as-a-Service (SaaS) providers use AI. Large cloud computing providers like Amazon offer AI-as-a-Service (AIaaS) to manage vast data volumes, which healthcare providers and business associates may use. However, the usage of AI by SaaS can pose risks to PHI if healthcare providers do not thoroughly review and negotiate online terms of service, click agreements, and privacy policies.

Complexity of AI in Healthcare

AI is involved in various healthcare aspects, including record keeping, diagnostic imaging, triage, prescription dispensing, billing, staffing, and patient satisfaction evaluation. The integration of AI in healthcare legal departments combines the complexities of healthcare, AI, and the law, necessitating tailored guidance.

Potential Recommendations

1) **Engagement with Healthcare IT Professionals**: The State Bar should interact with Chief Legal Officers (CLOs), Chief Information Officers (CIOs), Chief Privacy Officers (CPOs), Chief Information Security Officers (CISOs), and risk management professionals to understand their perspective on AI use in healthcare.
2) **Public Information and Awareness**: Provide accessible information to lawyers and the public about AI's current use in healthcare, its impact on patient care, and patient rights.
3) **Continuing Legal Education Programs**: Offer CLE programs for lawyers and judges to understand how healthcare providers, device manufacturers, covered entities, business associates, and subcontractors use AI. This understanding is crucial for the protection of safety and efficacy, patient care and rights, physical judgement, and PHI and to assist these entities effectively.

Legal Education

Overview

Importance of Understanding AI in Legal Education

Recognizing the significant influence that AI has on the ethical practice of law and case management in courts, it's essential for law school education to address how AI affects these areas. This understanding is crucial for preparing law students for their future roles as lawyers and judges.

AI as an Educational Tool

AI can be beneficial for law students to better comprehend the practice of law, which would ultimately benefit all lawyers and judges. However, there's a concern that an overreliance on AI could lead to a deficiency in the essential skills and knowledge required for legal and judicial careers.

Experiences with Generative AI in Law Schools

Early experiences with generative AI reflect some of the persistent concerns over its use by law students.

1) The University of Michigan Law School prohibited the use of ChatGPT on student application essays.
2) The University of California Berkeley School of Law adopted a formal policy on the use of AI by students but did not pass an outright ban.
3) In a study analyzing ChatGPT's performance on the bar exam, Chicago-Kent College of Law professor Daniel Katz and Michigan State College of Law professor Michael Bommarito found that the AI got answers of the Multistate Bar Exam correct half of the time, compared to 68% for human test takers.
4) Law professors at the University of Minnesota Law School conducted a study which showed ChatGPT performing on average at the level of a C+ student, earning a low but passing grade in four courses. The same researchers authored a follow-up study, Lawyering in the Age of Artificial Intelligence, in November 2023. It found that while use of AI led to consistent and significant improvements in the speed of law students' work on common legal tasks (enhancing it by as much as 32%), AI did not really improve the quality of the work.
5) Legal writing professors interviewed by the ABA Journal who used ChatGPT in writing classes concluded that the AI tool can model good sentence structure and paragraph structure and aid in summarizing facts.

The use of AI in law schools can present the opportunity for certain efficiencies and familiarize students with technology used in practice, but AI is no substitute for a student's own analysis.

Potential Recommendations

1) **Balancing AI Use with Traditional Learning**: A practical solution suggested is to modify legal education to encourage AI use among law students. At the same time, it is recommended that students be required to orally explain their research papers to ensure they retain critical thinking and understanding skills.
2) **Collaboration with Legal Education Institutions**: The State Bar should collaborate with law school deans and law professors to focus on using AI in practical law courses, thereby enhancing the practical aspects of legal education with AI technology.
3) **Mandatory Continuing Legal Education (MCLE) on AI**: The recommendation includes the State Bar mandating MCLE courses about the ethical and practical uses of AI for young lawyers, particularly in the first five years following their passing of the bar exam.
4) **AI Summit**: Consider recommending that the State Bar of Texas hold an "AI Summit," to which deans of the ten Texas law schools will be invited and encouraged to bolster technology law offerings to students, including but not limited to generative AI.
5) **Mandatory Court on AI for Recent Graduates**: Consider a requirement for recent law school graduates, along the lines of the mandatory Introduction to practice course currently in place, to complete a CLE course on the benefits and risks of generative AI.
6) **Ongoing Study**: Consider ongoing review and study of AI-related issues by the State Bar due to its rapid evolution and the advanced rate of adoption within the legal profession. Such ongoing study could include outreach to Texas law schools and providing guest speakers on the subject of generative AI.

The State Bar should encourage law schools to address AI topics in these Law School Courses:

TOPICS	LEGAL EDUCATION POINTS
1L Courses Which Should Include AI	Legal Research Writing Communication & Legal reasoning Foundation of the Legal profession Civil Procedure Legal Analysis & Persuasion
2L & 3L Courses Which Should Include AI	Administrative Law Basic Federal Income Taxation Business Associations Civil Procedure II Comparative Law Constitutional Criminal Procedure Conflict of Laws Estates and Trusts Evidence International Law Law Office Management Professional Responsibility Remedies

	Secured Transactions

Practical Uses

The legal community in Texas would benefit from a consideration of the possible practical uses of artificial intelligence.

Potential Recommendations

1) **Educational Outreach**: We recommend the development of a self-service presentation (slide deck) covering practical use cases and examples of responsible uses of AI. Bar members can review the presentation themselves, and we also recommend that it be presented at each bar section meeting at least once in 2024. To incentivize participation, we suggest offering CLE credits to attendees.
2) **Bar Magazine Articles**: To ensure that information reaches every member of the bar community, we propose the creation of concise one- or two-page articles that cover similar content to the presentation. These can be disseminated through the bar association's email newsletters or magazines, specifically tailored to cater to a less technical audience. The aim is to provide accessible and digestible insights into the world of AI and its relevance to legal practice.
3) **Paralegal Empowerment**: Recognizing the vital role paralegals play in the legal ecosystem, we recommend dedicating a one-page article in the Texas Bar Journal and Texas Paralegal Journal. This content should be tailored to address the unique perspectives and responsibilities of paralegals, making the integration of AI concepts relevant to their daily tasks.
4) **Community Building**: Fostering a sense of community and shared learning is crucial. We are considering recommending the creation of an AI affinity group that meets quarterly. This group would serve as a platform for members to share success stories, exchange insights, and collectively navigate the challenges posed by AI in the legal profession.
5) **Business Mentor Program**: To bridge the gap between tech-forward lawyers and those seeking guidance, we would like to explore designing a business mentor program for bar members. Experienced lawyers well-versed in technology can mentor another bar member, sharing ideas on how to incorporate tech into their practice. This could be designed in coordination with supporting retiring lawyers who want to transition their practice to the next generation of attorneys.
6) **Scholarship Fund for Upskilling**: Acknowledging the financial considerations of adopting AI tools, we propose the establishment of a scholarship fund. Bar members can apply for funds to purchase AI tools or reduce the cost of upskilling during this period of technology transition for the profession. Additionally, exploring potential bar discounts on AI tools would further support this initiative.
7) **List of Social Media Resources**: We recommend compiling a list of reputable groups and associated social media accounts on LinkedIn and Facebook so that bar members can continue to learn about AI in bite-size amounts over the course of the next few years.

Justice Gap

Overview

The “Justice Gap” refers to the tremendous unmet need for legal services among low-income persons. The Legal Services Corporation (LSC) 2022 Justice Gap Study revealed that 92% of the civil legal problems of low-income Americans did not receive any or enough legal help. Nearly three-quarters (74%) of low-income households experienced at least one civil legal problem in the previous year. A third (33%) of low-income Americans had at least one problem they attributed to the COVID-19 Pandemic. (https://www.lsc.gov/initiatives/justice-gap-research)

How Might Legal AI Help?

Legal AI technology will impact the justice gap on two fronts. First, by making lawyers more productive and thus allowing them to serve more clients, more quickly. Second, via self-help legal tools, in the form of chatbots, designed to be used directly by consumers. (https://www.lawnext.com/2023/09/thoughts-on-promises-and-challenges-of-ai-in-legal-after-yesterdays-ai-summit-at-harvard-law-school.html)

What Are the Potential Challenges or Pitfalls?

Particularly with respect to consumer self-help legal tools, there will be huge challenges in ensuring that data used in legal AI systems is valid and that legal answers consumers receive can be trusted. The subcommittee will survey Texas legal aid providers regarding how they plan to use AI tools in the provision of client services and also directly to clients in form of chatbots (Texas Legal Services Center is beginning to test chatbot technology as a component of its virtual court kiosks, only for the purpose of helping people use the kiosks (https://www.tlsc.org/kiosks)).

Potential Recommendations

The Subcommittee may study and make recommendations regarding the following:

1) strategies for ensuring that direct-to-consumer legal AI tools provide valid information that is usable and effective in helping solve legal problems
2) how to ensure self-help legal AI tools are accessible to people who may have limited internet access or low proficiency in using computers and mobile devices, or who are non-English speakers
3) ideas for supporting Texas legal aid providers as they build out their own legal AI tools
4) how to address the potential for unequal access to AI technology; that is, that legal aid providers will be shut out of access to expensive AI tools which may be accessible only by big firms and corporations; encourage legal technology vendors to provide low-cost access to such tools
5) the potential for AI technology to help with dispute resolution and dispute avoidance
6) ideas for innovative legal services platforms based on AI

Areas for Additional Research

The taskforce identified areas where additional research would be helpful.

1) **The Use of AI by Texas Lawyers**: The taskforce proposes to poll members of the Texas Bar to gain insight into how quickly the use of AI is spreading in the legal profession, and what AI tools are being used.
2) **The Use of AI by the Judiciary**: The taskforce proposed to poll members of the judiciary to gain insight into how AI is being used by and in the courts.
3) **Practical Application of AI**: The taskforce proposes identifying examples of Texas lawyers and judges applying AI to their work.

4) **Responses to AI in Other States**: Taskforces or committees in several states are studying the implications of AI in the practice of law. The taskforce is monitoring these efforts and will consider the findings and recommendations that result from them.

Collaboration

As the taskforce identified issues that span the legal profession, it became apparent that these issues impact other interest groups such as the courts, law schools, and legal regulators, to name a few. The taskforce is planning to invite other stakeholders to an AI Summit in the spring of 2024 to continue the discussion on the impact of AI on the legal profession.

Conclusion

In conclusion, the Taskforce for Responsible AI in the Law has begun to navigate the complex intersection of AI and legal practice. This interim report marks an initial step in our journey, outlining key areas of focus and preliminary recommendations. As we proceed, our work remains grounded in a commitment to thorough investigation and careful consideration of AI's implications for the legal profession. Our ongoing efforts aim to responsibly integrate AI, balancing innovation with the profession's foundational values and ethical standards. The taskforce will continue to diligently explore these emerging challenges, ensuring our final recommendations are informed, measured, and aligned with the evolving needs of the legal community.

Appendix A

Glossary of Useful Terms

The following definitions and key terms are helpful in understanding the report of the taskforce:

1) **Algorithm**: a step-by-step procedure or set of rules designed to perform a specific task or solve a specific problem
2) **Artificial Intelligence** (AI): the simulation of human intelligence in machines, programmed to think and learn like humans
3) **Bias in AI**: the tendency of an AI model to make decisions that are systematically prejudiced due to underlying assumptions in the algorithm or biases in the training data
4) **Chatbot**: a computer program that simulates human conversation through text or voice interactions, often powered by AI
5) **ChatGPT**: a specific type of generative large language model developed by OpenAI, designed to create human-like text based on the input it receives that utilizes deep learning and has been applied in various fields including natural language understanding, content creation, and conversation simulation
6) **Data Training**: the process of feeding data into an AI model to teach it specific behaviors and patterns, allowing it to learn and make predictions or decisions
7) **Deep Learning**: a subset of machine learning that uses neural networks with three or more layers, allowing for more complex and abstract pattern recognition
8) **Ethical AI**: refers to the practice of using AI in a manner that aligns with accepted moral principles and values, especially in terms of fairness, transparency, and accountability
9) **Generative AI**: AI models that create new, original content such as text, images, or music, based on the data they have been trained on
10) **Large Language Model (LLM)**: a type of machine learning model designed to understand and generate human-like text, used in various applications including content creation and natural language understanding
11) **Machine Learning (ML)**: a subset of AI, where algorithms allow computers to learn and make decisions from data without being explicitly programmed
12) **Natural Language Processing (NLP)**: a branch of AI focused on the interaction between computers and humans using natural language, enabling machines to read, interpret, and respond to human language
13) **Neural Network**: a computational model inspired by the way human brain cells work, used in machine learning to process complex patterns and relationships in data
14) **OpenAI**: an artificial intelligence research lab consisting of the for-profit OpenAI LP and its parent company, the non-profit OpenAI Inc. OpenAI is dedicated to advancing digital intelligence and conducts research on various AI topics including machine learning, deep learning, and natural language processing
15) **Reinforcement Learning**: a type of machine learning where agents learn to make decisions by receiving rewards or penalties based on the actions they take
16) **Supervised Learning**: a type of machine learning where algorithms are trained on a labeled dataset, which means the algorithm has access to an answer key while learning
17) **Unsupervised Learning**: a type of machine learning where algorithms are trained without any labeled response data, learning to identify patterns and structures within the input data

Taskforce for Responsible AI in the Law

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Taskforce for Responsible AI in the Law

Report on the 2024 Texas AI and Law Summit

February 26, 2024, Texas Law Center, Austin, Texas

Moderators:

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Hon. Xavier Rodriguez*
Hon. Roy Ferguson *
Lisa Angelo*
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Attendees:

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Recommendations

The Artificial Intelligence ("AI") Summit Attendees' discussion resulted in the following recommendations:

- TRAIL should request a formal ethics opinion on the use of AI and generative AI by lawyers, including when it can be used and how to bill for its use. As a result of the discussion during the Summit, TRAIL Chair John Browning sent a request to the Professional Ethics Committee requesting an ethics opinion and has received a letter confirming that the PEC is working on preparing an ethics opinion in response to the request
- For attorneys using AI, Texas Rule of Civil Procedure 13 places the burden of proof on the filer to ensure they understand what they are doing, while Chapters 9 and 10 of the Texas Civil Practice & Remedies Code ("CPRC") require reasonable diligence from the filer. The Supreme Court's Rules Committee should clarify the rules without being specific to AI and generative AI.
- The State Bar should educate lawyers and judges about the responsible use of AI and generative AI. This should include educational materials for judges, training on metadata, CLEs on prompting, data privacy, and responsible document sharing. Short-take CLE products and AI topics tailored to specific practice areas could also be effective. Education efforts could involve the Texas Access to Justice Commission ("ATJ"), the State Bar, pro bono groups, and other organizations, with resources provided on the State Bar website.
- A toolkit should be created, focusing on AI and cybersecurity more broadly, written in plain language, and maintained by the State Bar.

Executive Summary

The Taskforce for Responsible AI in the Law held an AI Summit in Austin at the Law Center on February 26, 2024. Members of the Taskforce moderated sessions on several issues identified by the Taskforce as important to lawyers in addressing the risks and opportunities presented by AI and generative AI. Topics included ethical use of AI, addressing AI through legal education, cybersecurity and privacy concerns, use of AI in the courtroom, and AI and access to justice. The Taskforce invited stakeholders from across the legal community to attend the discussion. The group of approximately 40 attendees included Supreme Court Senior Justice Lehrmann, Rules Attorney Nina Hsu, representatives from several Texas Law Schools, a representative from Texas Health Resources, and representatives from State Bar Committees including the CLE Committee, the Court Rules Committee, and the Law Practice Management Committee.

Ethical and Privacy Concerns

The AI Summit discussion focused on how the existing ethics rules apply to AI, and whether the existing rules are adequate in providing guidance to attorneys on how to use AI ethically. The group also considered whether additional ethics rules are necessary to provide attorneys with guidance and to protect clients.

The AI Summit attendees discussed AI broadly instead of focusing only on Generative AI. The AI Summit attendees noted that AI has become so pervasive in most technology applications that it is not feasible for attorneys to eliminate the use of AI, even if that were desirable. It would therefore not be feasible for an attorney to effectively represent a client without in some way making use of AI.

The AI Summit attendees also noted that ethical and effective representation of a client might require not using AI in some situations and using it judiciously in other situations. The possibility exists that as AI, particularly generative AI, becomes more pervasive, failing to utilize this technology might be unethical in that the attorney is not adequately using the tools available.

2018 Ethics Opinion 680 requires lawyers to understand the technology they use, including cloud services. TRAIL's Interim Report proposed requesting a formal ethics opinion on the use of AI by lawyers, including when it can be used and how to bill for its use. The discussion at the Summit supported this recommendation.

An ethics committee should define due diligence for electronic services, as the level of risk varies among AI applications.

Transparency in AI is expected to improve, and lawyers need to review privacy notices and terms of service. Debate exists on whether increasing the technology CLE requirement is necessary, as market forces may address the issue and lawyers learn about AI risks quickly.

While the AI Summit discussion did not propose drafting additional ethics rules specifically addressing AI, the group did note that any new rules should be AI-agnostic, emphasizing the lawyer's responsibility for the contents of signed documents.

AI in the Courtroom

Discussion by the AI Summit attendees about the role of AI and generative AI tools in the courtroom focused on three areas: the use of AI by pro se litigants, the use of AI by attorneys, and the use of AI by court staff.

Pro se litigants will likely use any available AI tools, especially if they are free and accessible. Courts may want to warn pro se litigants about the risks of AI and legal research, potentially through clerks, standing orders, or pro se and self-help centers. Concerns exist about pro se litigants becoming overconfident in their case due to AI-generated content.

For attorneys using AI, Rule 13 places the burden of proof on the filer to ensure they understand what they are doing, while Chapters 9 and 10 of the CPRC require reasonable diligence from the filer. The Supreme Court's Rules Committee could clarify the rules without being specific to AI and generative AI. In addition to the risks inherent in using AI, there are potential benefits for attorneys. For instance, a free AI tool that checks citations for hallucinations could benefit good actors.

Nearly a quarter of judges use AI, and while responsible use in drafting opinions is permissible, requiring disclosure of AI use is not recommended. Standing orders educating about AI are encouraged, but those requiring disclosure are not.

Deep fakes and the authenticity of evidence are concerns, and Texas Rule of Evidence 901 should be reexamined in this context.

Recommendations include reviewing educational materials for judges, considering pretrial hearings for evidentiary challenges, and providing training on metadata. Education efforts could involve the ATJ, State Bar, Pro Bono Law Group, and other organizations, with resources provided on the State Bar website.

AI in Legal Education

Law schools should be encouraged to address the challenges and benefits of technology and AI in their curricula. AI education could be embedded in legal writing courses or offered through short CLE presentations. The State Bar can support law schools by clarifying what "professional competence" means concerning AI and offering nuts-and-bolts education for new lawyers.

Law students need to understand the terms of use of AI services, data privacy, and the complexity of de-identification.

CLEs on prompting, data privacy, and responsible document sharing could be helpful. Short-take CLE products and AI topics tailored to specific practice areas could also be effective.

Real-time, AI-driven spoken communication might transform how people learn about AI.

AI and Cybersecurity

AI is being used to create more effective phishing emails and malware, with threat actors patiently collecting information before attacking.

Continuous training is crucial for all staff members, not just attorneys. Cybersecurity issues need to be translated into plain language for better understanding. Solo and small firm attorneys need resources and toolkits, particularly regarding cyber insurance.

The State Bar could remind attorneys about the availability of cybersecurity insurance and resources. Cyber insurance requires affirmative steps to protect data and may not cover all potential problems.

Lawyers should understand where their data resides and take advantage of free resources for training and risk assessments.

A toolkit should be created, focusing on AI and cybersecurity more broadly, written in plain language, and maintained by the State Bar.

AI and Access to Justice

The AI Summit attendees discussed the potential benefits of AI and generative AI for increasing access to justice. However, many attendees also expressed concern that AI and generative AI is not an adequate substitute for qualified legal assistance. Concerns were raised about over-reliance on AI and generative AI as a method of providing low-cost legal services. Some members of the group proposed considering safe harbors or coverage for attorneys doing pro bono work with AI, while some members opposed this proposal.

Other proposals included increasing support and funding for legal aid to serve as a testing ground for AI adoption and exploring the use of AI, including AI and generative AI videos, to create more educational and empathetic resources for pro se litigants.

Tab C

Memo

To: Texas Supreme Court Advisory Committee

From: Subcommittee on Rules 1-14c

Date: August 8, 2024

Subject: Review of Potential Rule Amendments to Address Artificial Intelligence

On July 17, 2024, the Texas Supreme Court referred the following topic to the Texas Supreme Court Advisory Committee:

> **Artificial Intelligence**. The State Bar of Texas's Taskforce for Responsible AI in the Law has issued the attached interim report recommending potential changes to the Texas Rule of Civil Procedure 13 and Texas Rule of Evidence 901. The Committee should review, advise whether such amendments are necessary or desirable to account for artificial intelligence, and draft any recommended amendments.

This referral was assigned to the Rules 1-14c Subcommittee Chaired by Judge Harvey Brown. The following is the Report of the Subcommittee.

I. Introduction and Summary of Recommendations

In this Memo,[1] the Subcommittee describes some of the unique risks and concerns for our courts and legal system sparked by the rapid development of AI. The Subcommittee also reviews how other states and federal courts have responded through standing orders, rulemaking and ethics opinions. The Subcommittee discusses the Interim Report of the Texas State Bar Taskforce for Responsible AI in the Law (Taskforce) and its 2023-24 Year-End Report and recommendations that pertain to potential rulemaking. Appendix A is a brief overview of AI and the transformative impacts of Generative AI and Large Language Models and resources on AI and federal and state court rules addressing AI.

A. Recommendation on Amending TRCP 13

The Subcommittee reviewed the Taskforce's recommendations (both in its Interim Report and 2023-24 Year-End Report) suggesting that the Advisory Committee should consider amending Rule 13 to highlight the duty of both attorneys and self-represented litigants regarding the use of AI in connection with pleadings, motions and other papers. Notwithstanding the Taskforce's suggestions, the Subcommittee concludes that amending Rule 13 is unnecessary because self-represented litigants are unlikely to focus on revised language in Rule 13 and attorneys practicing in Texas understand their duty to be competent in the use of technology (and the Subcommittee anticipates that the Texas Committee

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[1] Note that this memo was prepared with the assistance of Generative AI (CoPilot).

on Professional Ethics will follow the Taskforce's recommendation to issue a more specific Ethics Opinion on the ethical considerations related to attorneys' use of AI).

To the extent the Committee concludes an amendment to Rule 13 is advised, the Subcommittee recommends the following language:

RULE 13. EFFECT OF SIGNING PLEADINGS, MOTIONS AND OTHER PAPERS; SANCTIONS

The signatures of attorneys or parties constitute a certificate by them that they have read the pleading, motion, or other paper; that to the best of their knowledge, information, and belief formed after reasonable inquiry the instrument is not groundless and brought in bad faith or groundless and brought for the purpose of harassment. Attorneys or parties who shall bring a fictitious suit as an experiment to get an opinion of the court, or who shall file any fictitious pleading in a cause for such a purpose, or shall make statements in pleading which they know to be groundless and false, for the purpose of securing a delay of the trial of the cause, shall be held guilty of a contempt. The use of generative Artificial Intelligence in connection with any signed pleading, motion, or other paper must comply with this Rule. If a pleading, motion or other paper is signed in violation of this rule, the court, upon motion or upon its own initiative, after notice and hearing, shall impose an appropriate sanction available under Rule 215-2b, upon the person who signed it, a represented party, or both. Courts shall presume that pleadings, motions, and other papers are filed in good faith. No sanctions under this rule may be imposed except for good cause, the particulars of which must be stated in the sanction order. "Groundless" for purposes of this rule means no basis in law or act and not warranted by good faith argument for the extension, modification, or reversal of existing law. A general denial does not constitute a violation of this rule. The amount requested for damages does not constitute a violation of this rule.

Notes and Comments

Comment to 1990 change: To require notice and hearing before a court determines to impose sanctions, to specify that any sanction imposed be appropriate, and to eliminate the 90-day "grace" period provided in the former version of the rule.

Comment to 2024 change: Attorneys and parties (including self-represented parties) should understand that pleadings, motions or other papers that include content from generative Artificial Intelligence tools are subject to the certification obligation of this rule.

The Subcommittee suggests that if there is a consensus to amend Rule 13, the reference to AI should be included in a new Comment to the Rule (in the format above), instead of amending the text of the Rule.

B. Recommendation on Amending the Rules of Evidence

The Subcommittee recommends that the Advisory Committee review and consider amending Rules of Evidence 901 and 902 on authentication of evidence created or altered by generative AI tools.[2] Potential changes to Rule 901(b)(9) would include additional authentication steps if a party seeks to introduce AI created records into evidence. The Subcommittee also recommends evaluation of inserting a new Rule 901(c) to set out a procedure for a party to challenge the authenticity of computer-generated or other electronic evidence. This change is due to the risk of falsification or modification of photographs, videos and recordings using AI tools without any indication that the item is not genuine.

The Subcommittee also recommends that the Advisory Committee consider amending Rule 902(10) which details the language required for a Business Records Affidavit used for Self-Authenticating evidence under TRE 902.

C. Recommendation on Amending TRCP 226a

Although not referenced in the Supreme Court's Referral, the Subcommittee also suggests that the Advisory Committee consider and refer to the Rules 216-299a Subcommittee whether to amend the TRCP 226a Instructions to Jury Panel and Jury to direct that potential jurors and empaneled jurors should not access AI tools to investigate information or other resources regarding the case before them. It also recommends updating the language to reflect changes in technology.

II. AI use in the Legal Profession

Chief Justice John Roberts in his 2023 Year-End Report on the Federal Judiciary commented on the potential that technology and particularly AI will have on the practice of law. "As 2023 draws to a close with breathless predictions about the future of Artificial Intelligence, some may wonder whether judges are about to become obsolete. I am sure we are not—but equally confident that technological changes will continue to transform our work."[3] The legal community has long relied on computer applications that incorporate some forms of artificial intelligence, including writing tools such as Grammarly® and legal research tools Westlaw® and Lexis®.

Attorneys were very quick to realize the potential of Generative AI in the legal profession and Generative AI will transform the practice of law. Examples include using AI to review and assess contract terms and potentially suggesting additional clauses, analyzing large volumes of data, streamlining the discovery process, automating due diligence reviews, quickly summarizing depositions and recording transcripts and suggesting well-crafted arguments. "Attorneys could spend more time on client relations than contract drafting. Courts could identify better ways to help individuals through the legal system and resolve disputes. Self-represented litigants could navigate some legal problems without

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[2] The Subcommittee anticipates that the input of the Texas State Bar Evidence Committee will be requested prior to any final recommendation by the Committee.

[3] https://www.supremecourt.gov/publicinfo/year-end/2023year-endreport.pdf

having to pay for an attorney. However, along with the extraordinary potential of generative AI, we should not lose sight of the extraordinary risks it poses."[4]

The risks of AI in the legal profession were manifested quite quickly when a litigation attorney used ChatGPT to research supportive case precedent when drafting a brief in support of the plaintiff's opposition to a motion to dismiss in a case pending in the U.S. District Court for the Southern District of New York, *Mata v. Avianca*; (1:22-cv-01461). The attorney did not realize that ChatGPT's suggested cases and holdings were completely fabricated to resemble actual decisions. Unfortunately, the attorney did not check whether the citations were real before filing his response. The fake cases were soon discovered and the lawyer filing the motion was sanctioned by the court. He also endured public humiliation.[5]

An interesting and thoughtful initiative on AI and the legal system was formed at Duke University Law School called Responsible AI in Legal Services, or RAILS. The initiative describes its mission as follows: "[To] [b]ring together a cross-industry group of leaders (judiciary, corporations, law firms, tech providers, access to justice orgs, etc.) to support the responsible, ethical, and safe use of AI to advance the practice of law and delivery of legal services to all."[6] The Steering Committee includes Paul Grimm, former U.S. District Judge and Director of Duke's Bolch Judicial Institute. The National Center for State Courts (NCSC) also has initiated the exploration of judicial and legal ethics issues involved with AI and the Courts.[7]

A. Impact of AI in Litigation

The risks and concerns triggered by AI, particularly those impacting the legal profession and the justice system, quickly became apparent and will take time to work through courts and rulemaking bodies. A December article in the Duke Law School's Law & Technology Review described some of the issues and challenges to law and the legal system because of Generative AI:

> Generative AI ("GenAI") systems such as ChatGPT recently have developed to the point where they are capable of producing computer-generated text and images that are difficult to differentiate from human-generated text and images. Similarly, evidentiary materials such as documents, videos and audio recordings that are AI-generated are becoming increasingly difficult to differentiate from those that are not AI-generated. These technological advancements present significant challenges to parties, their counsel, and the courts in determining whether evidence is authentic or fake. Moreover, the explosive proliferation and use of GenAI applications raises concerns about whether litigation costs will dramatically increase as parties are forced to hire forensic experts to address AI generated evidence, the

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[4] Griffin, Laskowski and Thumma, *How to Harness AI for Justice* | Judicature (duke.edu) 108 Judicature 1, 2024

[5] Lawyer cited 6 fake cases made up by ChatGPT; judge calls it "unprecedented" | Ars Technica. ('Adding insult to injury', the plaintiff's case was dismissed by the trial court.)

[6] About RAILS | Responsible AI in Legal Services

[7] AI and the Courts: Judicial and Legal Ethics Issues (ncsc.org)

> ability of juries to discern authentic from fake evidence, and whether GenAI will overwhelm the courts with AI-generated lawsuits, whether vexatious or otherwise. GenAI systems have the potential to challenge existing substantive intellectual property ("IP") law by producing content that is machine, not human, generated, but that also relies on human-generated content in potentially infringing ways. Finally, GenAI threatens to alter the way in which lawyers litigate and judges decide cases.[8]

In the preparation of this report, CoPilot was asked the following: What are potential risks to our court system because of AI? This was CoPilot's response:

> The integration of AI into our court system brings several potential risks:
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> 1. **Over-reliance on AI**: There's a risk of over-reliance on AI without assessing its quality and reliability. AI systems are not infallible and their outputs should be scrutinized for accuracy.
> 2. **Inaccurate or biased information**: AI systems can provide inaccurate or biased information. Biased data sets can lead to skewed outcomes or prejudice against improperly represented groups.
> 3. **Potential for fraudulent practices**: The use of AI opens up new avenues for fraudulent practices.
> 4. **Influence of commercial actors**: There's a risk of commercial actors influencing public interest.
> 5. **Lack of empathy or human support**: AI systems lack the ability to provide empathy or human support, which is often crucial in legal proceedings.
> 6. **Reinforcing existing biases**: AI systems can reinforce existing biases if they're trained on biased data.
> 7. **Unequal access to AI tools**: Not everyone has equal access to AI tools, which could lead to inequality in the legal system.
> 8. **Security risks**: AI systems in the judiciary can become a weak point for criminals, terrorist groups, and governments with malicious intent to take advantage of.
> 9. **Decrease in the number of civil servants**: The digitalization of legal services could cause a decrease in the number of civil servants.
> 10. **Threats to personal privacy**: The accumulation of massive amounts of personal information in the hands of a few, unregulated big-tech companies with unabashedly selfish commercial interests.
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> These risks highlight the need for careful consideration and regulation as we integrate AI into our legal systems. It's important to ensure that the use of AI in the court system is transparent, fair, and doesn't compromise the rights of individuals.[9]

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[8] Grossman, Grimm, Brown and Zu, *The ChatGPT Judge: Justice in a Generative AI World*, 23 Duke Law & Technology Review, 1 (October 2023)

9 CoPilot query August 1, 2024 (Ironically, the Bluebook has not yet issued guidance on how to cite to AI generated content, underscoring one of the many challenges with the use of AI in legal proceedings.)

B. AI Issues that Will Need to Be Addressed by Courts

Generative AI and its impact on courts and litigants include the following considerations:

- Accuracy, reliability and authenticity of AI Generated information, including whether the output can be repeated
- The potential that uses of AI could compromise proprietary information as well as personal health and personally identifying information
- Does the attorney client privilege/work product doctrine apply to AI prompts from counsel and the Tool's responses?
- Are prompts (questions posed in AI) and output subject to legal holds?
- What is the 'chain of custody' with respect to AI output?
- Who owns output generated by AI tools and is an AI inquiry or answer a declarative statement (that could be held against interest)?
- Jurors independently asking Generative AI tools for information related to the case they are adjudicating.
- Confidentiality of Information inputted into LLMs
- Is an AI generated response hearsay and if so, can it be considered a business record?
- How is AI output authenticated?
- Can AI output be considered as 'expert' testimony?

III. AI Rulemaking by State and Federal Courts

Court systems around the U.S. have quickly responded to the AI revolution by implementing local rules, standing orders, and ethics rules to address perceived risks triggered by the technology.[10] As noted below, some of the early orders requiring disclosure of the use of AI have proven to be ineffective.

A. Standing Orders Requiring Disclosure of the Use of AI

Following the press stories on the *Mata v. Avianca* pleading debacle described above, many courts (state and federal) adopted local standing rules requiring disclosure of the use of AI in pleadings. An example of a standing order is the version adopted by Federal Judge Michael Baylson of the U.S. District Court for the Eastern District of Pennsylvania. His standing order requires:

> If any attorney for a party, or a pro se party, has used Artificial Intelligence ("AI") in the preparation of any complaint, answer, motion, brief, or other paper filed with the Court and assigned to Judge Michael M. Baylson, they MUST, in a clear and plain factual statement,

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[10] Two very useful tools to track AI rulemaking in state and federal courts includes Generative Artificial Intelligence (AI) Federal and State Court Rules Tracker (lexis.com) and RAILS dynamic list of over 58 State and Federal Court Orders and Ethical Rules related to AI.

> disclose that AI has been used in any way in the preparation of the filing and CERTIFY that each and every citation to the law, or the record in the paper, has been verified as accurate.

U.S.D.J. Araceli Martinez-Olguin of the N.D. of California requires a similar duty of disclosure for lawyers and pro se parties practicing in her court: "Any submission containing AI-generated content must include a certification that you have personally verified the content's accuracy. You are responsible for maintaining records of all prompts or inquiries submitted to any generative AI tools in the event those records become relevant at any point.[11]"

U.S.D.J. S. Kato Crews, (D. Colorado) requires a statement on whether AI was used for every paper filing:

> [E]very motion filed pursuant to Fed. R. Civ. P. 12, Fed. R. Civ. P. 56, and any opposed motion (to include the corresponding response and reply), shall contain a Certification regarding the use, or non-use, of generative artificial intelligence (AI) (such as ChatGPT, Harvey.AI, Google Bard, etc.) in preparing the filing. The preparer of the filing must certify either that (a) no portion of the filing was drafted by AI, or that (b) any language drafted by AI (even if later edited by a human being) was personally reviewed by the filer or another human being for accuracy using print reporters or traditional legal databases and attesting that the legal citations are to actual existing cases or cited authority. The Court will strike any filing from a party who fails to include this certification in the above-mentioned motions. The AI Certification does not count against any page limitations.[12]

In an interesting development on the trend of local rules mandating disclosure of the use of Generative AI, on November 22, 2023, the Fifth Circuit Court of Appeals proposed the amendment of its Rule 32.3 and Form 6 which would require the following certification:

> Additionally, counsel and unrepresented filers must further certify that no generative artificial intelligence program was used in drafting the document presented for filing, or to the extent such a program was used, all generated text, including all citations and legal analysis, has been reviewed for accuracy and approved by a human.[13]

On June 12, 2024, the Fifth Circuit announced that it would not implement the proposed rule, announcing:

> The court, having considered the proposed rule, the accompanying comments, and the use of artificial intelligence in the legal practice, has decided not to adopt a special rule regarding the use of artificial intelligence in drafting briefs at this time. Parties and counsel are reminded of their duties regarding their filings before the court under Federal Rule of Appellate Procedure 6(b)(1)(B). Parties and counsel are responsible for ensuring that their filings with the court, including briefs, shall be carefully checked for truthfulness and accuracy as the rules already require. "I used AI" will not be an excuse for an otherwise sanctionable offense.[14]

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[11] https://www.cand.uscourts.gov/wp-content/uploads/2023/03/AMO-Civil-Standing-Order-11.22.2023-FINAL.pdf

[12] SKC_Standing_Order_Civil_Cases.pdf (uscourts.gov) at 5.

[13] *See* 5th Circuit Notice of Proposed Amendment to 5th Circ. R. 32.2, Nov. 22, 2023

[14] 5th Circuit Notice of Decision on Proposed Rule, June 12, 2024

Notwithstanding the early trend of Courts to adopt rules on mandatory disclosure of the use of AI tools in court pleadings, the recent trend suggests that these rules are not practical and not particularly helpful to courts.

B. Local Rules Prohibiting the Use of AI

The Eastern District of Missouri has expressly prohibited Self-Represented Litigants (SRL) from using any form of generative AI in preparing any pleading: "No portion of any pleading, written motion, or other paper may be drafted by any form of generative artificial intelligence. By presenting to the Court (whether by signing, filing, submitting, or later advocating) a pleading, written motion, or other paper, self-represented parties and attorneys acknowledge they will be held responsible for its contents. See Fed. R. Civ. P. 11(b).[15]" U.S.D.J. Donald W. Molloy of the D. Mont. also has entered case specific orders prohibiting the use of generative AI in connection with the case.[16]

C. Standing Orders on AI that Do Not Require Disclosure of AI

Commentators have suggested that mandatory AI disclosure rules are fraught with problems and are counterproductive. An article in Judicature Magazine noted: "[w]hile the impulse underlying the imposition of these standing orders is understandable – even commendable – real disadvantages can result." The authors instead propose that the better alternative is consistent, court-wide rules that are enacted following publication and public comment.[17]"

The United States District Court for the Northern District of Illinois adopted a local rule for all matters in the District that explains its methodology and implements the Judicature article's recommendation:

> Some of the Court's standing orders address the Court's idiosyncrasies, such as its procedures for filing summary judgment motions. But other standing orders—which are unfortunately necessary—are often terse reminders that *all filers* need to follow statutes, the Federal Rules of Civil Procedure, and the Local Rules for the U.S. District Court for the Northern District of Illinois. The Court believes that a reasonable standing order on the use of artificial intelligence (AI) would fall into the latter category. So here's this Court's standing order on AI: Anyone—counsel and unrepresented parties alike—using AI in connection with the filing of a pleading, motion, or paper in this Court or the serving/delivering of a request, response, or objection to discovery must comply with Rule 11(b) and Rule 26(g) of the Federal Rules of Civil Procedure, and any other relevant rule, including any applicable ethical rule.[18]

U.S. District Court Judge Rita Lin (also of the N.D. California) follows a somewhat similar approach to the N.D. Illinois; It does not require certification but counsel have an ethical duty in connection with any filing:

> Counsel is responsible for providing the Court with complete and accurate representations of the record, procedural history, and cited legal authorities. Use of ChatGPT or other such generative artificial intelligence tools is not prohibited, but counsel must personally confirm for

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[15] Self-Represented Litigants (SRL) | Eastern District of Missouri | United States District Court (uscourts.gov)

[16] See e.g. Belenzon v. Paws Up Ranch, LLC, Case No. 9:23-CV-69, Dkt. No. 8

[17] Maura R. Grossman, Paul W. Grimm & Daniel G. Brown, Is Disclosure and Certification of the Use of Generative AI Really Necessary?, 107 Judicature 68 (2023)

[18] https://www.ilnd.uscourts.gov/judge-cmp-detail.aspx?cmpid=1409 (emphasis added)

> themselves the accuracy of any research conducted by these means, and counsel alone bears ethical responsibility for all statements made in filings.[19]

Other Federal Court Judges, including District Judge James Soto (U.S. Dist. Ct., Arizona) reminded the parties and their counsel in a specific case regarding the risks of the use of AI:

> If any portion of a pleading or other document filed on this Court's docket has been drafted (in whole or in part) using generative artificial intelligence, including, but not limited to ChatGPT, Harvey.AI, or Google Bard, all attorneys and pro se litigants filing such pleadings or other documents shall verify that any language that was generated in any form by AI was checked for accuracy by using print reporters, traditional legal databases, or other reliable means by a human being.[20]

D. Adoption of Ethical Rules related to the Use of AI

Bar organizations also have raised numerous ethical issues arising out of the use of AI. On July 29, 2024, the ABA issued Formal Opinion 512[21] that describes the ethical duties under Model Rule 1.1, including the expectation that attorneys are knowledgeable of AI technology and how it can be used and abused:

> Under Model Rule 1.1 (Competent Representation), you have an ethical obligation to understand the benefits and risks of any generative AI you use. Using generative AI might also implicate other duties under the Rules of Professional Conduct, like communicating with the client or charging reasonable fees.
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> As generative AI tools continue to develop, you may need to use them to provide competent legal services to your clients. However, you must evaluate the risks of client confidential information being disclosed or accessed by others when using generative AI tools. If your client specifically asks about your generative AI practices, you should disclose how you are using the technology in your representation.
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> The amount of review or verification you must do to meet your ethical obligation depends on the generative AI tool and the task being performed. Consider doing the following:
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> - Reading about generative AI targeted at the legal profession
> - Attending relevant continuing legal education programs –and–
> - Consulting others who are proficient in generative AI technology

The Washington DC Bar Association also issued an Ethics Opinion on AI[22] that includes the following guidance:

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[19] 2024-05-17-Civil-Standing-Order.pdf (uscourts.gov)

[20] Cowan v. Bd. Of Immigration Appeals, Case No. 4:23-cv-00327-JAS, Dkt. No. 15.

[21] Formal Opinion 512 (americanbar.org), July 29, 2024.

[22] DC Bar - Ethics Opinion 388

- You should have a reasonable and current understanding of generative AI works and what it does, including (a) its potential dangers such as risk of "hallucinations", misuse, or exposure of client confidential information; (b) its limitations, including whether it uses a narrow dataset that could generate incomplete, out-of-date, or inaccurate results; and (c) its cost
- You must review and validate AI generated content before incorporating it in your work product for clients or relying on it in support of a legal proceeding
- You must ensure the confidentiality of the information provided to the generative AI tool
- You should take appropriate steps to ensure that any use of generative AI is consistent with the Rules of Professional Conduct
- In litigation or arbitration, you must confirm that any generative AI outputs do not contain misrepresentations of facts or law, or provide fake citations
- If you intend to bill your client for your use of generative AI for which there is an out-of-pocket cost, you should communicate that expected expense to your client
- You can only bill for the time you actually spent on a matter, not the time you would have spent absent using generative AI
- Consider whether specific interactions with generative AI in connection with a client matter should be retained as part of the client file

The California State Bar Committee on Professional Responsibility and Conduct (COPRAC) made a similar recommendation to adopt an ethical standard for the use of AI: “When using generative AI tools, lawyers must ensure, among other things, client confidentiality, competent use of AI tools, supervision of lawyers and non-lawyers when using generative AI, and candor with the court and clients.[23]”

The New York State Bar Association Taskforce on AI recommended NY adopt ethical rules on AI, including the recommendation that attorneys should alert their clients when using AI tools: “When using AI tools in your case, you should advise clients of this usage and ensure legal staff, including paralegals, are properly trained and handling AI tools properly. Also consider responsibly using AI tools to aid in effectiveness in representing clients. However, you should periodically monitor the AI tool provider to learn about any changes that might compromise client confidentiality.[24]

The Michigan Bar issued an ethics opinion focused on judges rather than litigants.

> Judges have an ethical obligation to understand technology, including AI, "and take reasonable steps to ensure AI tools on which their judgment will be based are used properly." Further, judges "have an ethical duty to maintain technological competence and understand AI's ethical implications to ensure efficiency and quality of justice."[25]

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[23] https://s3.documentcloud.org/documents/24166448/recommendations-from-committee-on-professional-responsibility-and-conduct-on-regulation-of-use-of-generative-ai-by-licensees-1.pdf

[24] NYSBA Task Force on AI Recommendations (nysba.org)

[25] State Bar of Michigan’s Standing Committee on Judicial Ethics: Ethics Opinion JI-155

IV. Texas Taskforce on AI and the Courts

On August 25, 2023, then Texas State Bar President Cindy Tisdale created The Texas Bar Taskforce for Responsible AI in the Law (TRAIL or Taskforce). The Taskforce issued an Interim Report[26] on January 26, 2024 and followed up in June 2024 with its 2023-24 Year-End Report[27] with more detailed recommendations. (The Taskforce also met on February 26, 2024, in a Summit and issued a Report Summit Report.)[28]

The Taskforce in its Year-End Report described its work as follows: "This report represents an initial step in understanding the integration of AI within the legal profession. This report identifies the areas in which AI is already changing the practice of law and outlines recommended steps as this technology evolves. These recommendations are broad, reflecting the way that AI has touched nearly every area of legal practice."[29]

The 2023-24 Year-End Report set out 15 Substantive Recommendations, including the following two related to potential amendments to rules:

> 5. **Review of Texas Rule of Civil Procedure 13**. The Supreme Court of Texas Rules Advisory Committee and the State Bar of Texas Court Rules Committee should explore Texas Rules of Civil Procedure 13, "Effect of Signing Pleadings, Motions and Other Papers; Sanctions," and evaluate whether additional language or guidance is necessary for Texas lawyers and self-represented litigants regarding the need to verify the accuracy of all filings and an obligation to avoid AI-generated misinformation or hallucinations, as well as to provide Texas judges with adequate remedies regarding the same.
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> 6. **Rules of Evidence**. The Rules Advisory Committee and Court Rules Committee should also address whether changes to the Texas Rules of Evidence are needed to address deep fakes and AI-manipulated evidence.[30]

These recommendations were also discussed in the Taskforce's Interim Report at page 5 (recommended review of changes to Rule 13) and page 7 (discussion of evidentiary issues involving deepfakes).[31]

The Summit Report's section on AI in the Courtroom is particularly instructive to the Advisory Committee and is set out below in full (emphasis added):

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[26] Interim Report to the Board -- Taskforce for Responsible AI in the Law (texasbar.com)

[27] TRAIL 2023-24 Year-End Report

[28] Taskforce for Responsible AI in the Law, Summit Report February 26, 2024

[29] TRAIL 2023-24 Year-End Report at 4

[30] *Id*. at 7.

[31] Interim Report at 5 and 7.

AI in the Courtroom

Discussion by the AI Summit attendees about the role of AI and generative AI tools in the courtroom focused on three areas: the use of AI by pro se litigants, the use of AI by attorneys, and the use of AI by court staff.

Pro se litigants will likely use any available AI tools, especially if they are free and accessible. Courts may want to warn pro se litigants about the risks of AI and legal research, potentially through clerks, standing orders, or pro se and self-help centers. Concerns exist about pro se litigants becoming overconfident in their case due to AI-generated content.[32]

For attorneys using AI, Rule 13 places the burden of proof on the filer to ensure they understand what they are doing, while Chapters 9 and 10 of the CPRC require reasonable diligence from the filer. The Supreme Court's Rules Committee could clarify the rules without being specific to AI and generative AI. In addition to the risks inherent in using AI, there are potential benefits for attorneys. For instance, a free AI tool that checks citations for hallucinations could benefit good actors.

Nearly a quarter of judges use AI, and while responsible use in drafting opinions is permissible, requiring disclosure of AI use is not recommended. Standing orders educating about AI are encouraged, but those requiring disclosure are not.[33]

Deep fakes and the authenticity of evidence are concerns, and Texas Rule of Evidence 901 should be reexamined in this context.

Recommendations include reviewing educational materials for judges, considering pretrial hearings for evidentiary challenges, and providing training on metadata. Education efforts could

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[32] The Interim Report elaborated on this point: “While there has already been substantial publicity about inaccurate ChatGPT outputs and why attorneys must always verify any draft generated by any AI platform, the bench must also consider the impact of the technology on pro se litigants who use the technology to draft and file motions and briefs. No doubt pro se litigants have turned to forms and unreliable internet material for their past filings, but ChatGPT and other such platforms may give pro se litigants unmerited confidence in the strength of their filings and cases, create an increased drain on system resources related to false information and nonexistent citations, and result in an increased volume of litigation filings that courts may be unprepared to handle.” Interim Report at 7.

[33] The Interim Report explained this conclusion in more detail: “Because many legal research tools will (or already do) incorporate generative AI into their product, these standing orders may result in litigants disclosing their use of Westlaw, Lexis, Grammarly, etc. This is likely an unhelpful feature, and courts already have the ability to appropriately sanction an attorney for filing a motion or brief that contains false statements. It may also discourage the development and adoption of tools that, used properly, could enhance legal services.” Interim Report at 6.

involve the ATJ, State Bar, Pro Bono Law Group, and other organizations, with resources provided on the State Bar website.[34]

Following up its discussion in the Summit Report suggesting the issuance of a Texas ethics opinion on the responsible use of AI to bolster the 2018 Ethics Opinion 680 on lawyers' obligation to understand technology, the Taskforce formally submitted a request to the Texas Professional Ethics Committee, seeking "guidance on applying Texas Disciplinary Rules of Professional Conduct to the use of AI, including the lawyer's:

duty to provide competent representation (tech competence),

duty of confidentiality,

duty to safeguard client communications and property,

duty of supervision (both to other lawyers and to nonlawyer or virtual assistants),

duty of candor to the tribunal, and

duty to charge a reasonable fee."[35]

(Notably, the Summit Report included a recommendation that the ethics committee should "define due diligence for electronic services, as the level of risk varies among AI applications.")[36]

V. Proposed Amendment of TRCP 13

A. Discussions on Whether to amend FRCP 11

In evaluating whether to amend TRCP 13, it is initially instructive to explore the equivalent provision(s) in the Federal Rules of Civil Procedure and whether commentators believe Rule 11 is sufficient to empower judges deal with abuses arising out of the use of Generative AI.[37] Judge Grimm, Professors Grossman and Brown suggest that Federal Rules of Civil Procedure 11 (pleadings) and 26(g) (Discovery), together with attorneys' ethical obligations, sufficiently empower Federal Judges to address misuse of AI:

> Accordingly, lawyers or parties who violate Rules 11 and 26(g) in connection with their use of GenAI in civil litigation are already subject to sanctions that can be strong medicine — depending on the extent of the violation — regardless of whether the presiding judge has issued their own standing order concerning the use of GenAI. Moreover, if widespread public humiliation over being sanctioned by a court for committing this kind of error is insufficient disincentive, the Rules of Professional Conduct also impose independent ethical obligations to

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[34] Summit Report at 3-4.

[35] TRAIL 2023-24 Year-End Report at 5.

[36] Summit Report at 3. Notably, the Taskforce made the following observation: "The AI Summit attendees also noted that ethical and effective representation of a client might require not using AI in some situations and using it judiciously in other situations. The possibility exists that as AI, particularly generative AI, becomes more pervasive, failing to utilize this technology might be unethical in that the attorney is not adequately using the tools available."

[37] *See e.g.* Is Disclosure and Certification of the Use of Generative AI Really Necessary? | Judicature (duke.edu)

refrain from the types of misconduct that have led courts to adopt standing orders prohibiting or regulating the use of GenAI applications.[38]

B. TRCP 13 – No Amendment Needed

Texas Rule 13 includes a requirement that attorneys or parties sign pleadings, motions and other papers and by doing are certifying that "they have read the pleading, motion, or other paper; that to the best of their knowledge, information, and belief formed after reasonable inquiry the instrument is not groundless and brought in bad faith or groundless and brought for the purpose of harassment." (Federal Rule of Civil Procedure 11 which has a similar certification consequence only applies to filed pleadings and motions.)

Sanctions for violations of Rule 13 as well as violations of discovery and disclosure rules are available under Texas Rule of Civil Procedure 215.2b. Additionally, Texas Rule of Civil Procedure 191.3(b) (effect of signature on disclosures) and 191.3(c) (effect of signature on discovery request notice response or objection) also provide for sanctions for violations.

The Taskforce's suggestion that this Committee "evaluate whether additional language or guidance is necessary for Texas lawyers and self- represented litigants regarding the need to verify the accuracy of all filings and an obligation to avoid AI-generated misinformation or hallucinations, as well as to provide Texas judges with adequate remedies regarding the same." This suggestion was prompted by the fact that while Texas attorneys likely have an ethical duty regarding the use of AI, self-represented parties do not have any ethical duties. Thus, the duties of pro see litigants could be articulated in Rule 13. "The current version of Rule 13, however, requires that the pro se litigant arguably know, in advance of the filing of a motion, that the pleading is groundless and false. The Texas Supreme Court Rules Advisory Committee may wish to consider whether Rule 13 should be modified."[39] The Taskforce did not propose specific language amending Texas Rule of Civil Procedure 13.

The Subcommittee recommends that the Advisory Committee decline to amend Rule 13 to add a reference to AI. As reflected in the discussion above regarding courts' rush to add local rules requiring the disclosure of the use of AI which quickly proved to be impractical, amending Rule 13 will not ensure that self-represented litigants understand their duties to the court – importantly because self-represented litigants often do not review the Rules of Civil Procedure.

The Subcommittee proposes that the Advisory Committee recommend that a form be prepared for Self-Represented litigants in Texas that will be provided to the parties when filing their action or answer. This form should include general guidance and in addition information on the potential hazards related to AI technology. This will alert litigants of their duties and other important considerations in bringing civil litigation.

If the Advisory Committee disagrees and determines that Rule 13 should be amended, the following is a proposed approach to address AI:

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[38] *Id.*

[39] Interim Report at 7.

Proposed Amendment to Texas Rule of Civil Procedure 13

RULE 13. EFFECT OF SIGNING PLEADINGS, MOTIONS AND OTHER PAPERS; SANCTIONS

The signatures of attorneys or parties constitute a certificate by them that they have read the pleading, motion, or other paper; that to the best of their knowledge, information, and belief formed after reasonable inquiry the instrument is not groundless and brought in bad faith or groundless and brought for the purpose of harassment. Attorneys or parties who shall bring a fictitious suit as an experiment to get an opinion of the court, or who shall file any fictitious pleading in a cause for such a purpose, or shall make statements in pleading which they know to be groundless and false, for the purpose of securing a delay of the trial of the cause, shall be held guilty of a contempt. The use of generative Artificial Intelligence in connection with any signed pleading, motion, or other paper must comply with this Rule. If a pleading, motion or other paper is signed in violation of this rule, the court, upon motion or upon its own initiative, after notice and hearing, shall impose an appropriate sanction available under Rule 215-2b, upon the person who signed it, a represented party, or both. Courts shall presume that pleadings, motions, and other papers are filed in good faith. No sanctions under this rule may be imposed except for good cause, the particulars of which must be stated in the sanction order. "Groundless" for purposes of this rule means no basis in law or act and not warranted by good faith argument for the extension, modification, or reversal of existing law. A general denial does not constitute a violation of this rule. The amount requested for damages does not constitute a violation of this rule.

Notes and Comments

Comment to 1990 change: To require notice and hearing before a court determines to impose sanctions, to specify that any sanction imposed be appropriate, and to eliminate the 90-day "grace" period provided in the former version of the rule.

Comment to 2024 change: To highlight to attorneys and parties (including self-represented parties) that pleadings, motions or other papers that include content from generative Artificial Intelligence tools are subject to the certification obligation of this rule.

Alternatively, the proposed language could instead be added into the Notes and Comments section to advise attorneys and self-represented litigants that they are responsible for information obtained from Generative AI tools.

C. Is AI Subject to Disclosure under Texas Discovery Rules?

Although not the subject of the Supreme Court's referral, the Subcommittee notes that an open and interesting question is raised as to whether the existence of AI tools that were used to generate evidence in the dispute must be disclosed in response to Requests for Disclosure under TRCP 194.2. A similar question is prompted regarding whether AI tools themselves must be made available for inspection if these tools were used in connection with the expert's anticipated testimony or report.

Currently, TRCP 194.2(f)(4) reads as follows: "all documents, tangible things, reports, models, or data compilations that have been provided to, reviewed by, or prepared by or for the expert in anticipation of the expert's testimony." TRCP 194.2(f)(4) (emphasis added). Although this issue is likely to be the subject of future case law, it is not within the ambit of the Supreme Court's referral to this Committee and the Subcommittee does not believe that the Texas Rules should be amended at this time to resolve the issue.

VI. Amending the Rules of Evidence

The current Texas Rules of Evidence, particularly rules related to authentication of evidence, do not account for unique aspects of information produced or influenced by AI tools. These considerations include determining the accuracy and reliability of AI generated content, authentication and chain of custody questions of AI as well the significant risks related to deepfakes and manipulation of data using AI. The Texas Rules of Evidence fail to consider these unprecedented factors and therefore the Subcommittee recommends that potential amendments to Rules 901 and 902 should be provided to the Texas State Bar Evidence Committee for comment before final consideration by the Advisory Committee.

A. Rule 901 Authentication and AI

The Federal Rules of Evidence Advisory Committee recently initiated discussions on whether the Federal Rules of Evidence should be amended to reflect the unique impact of AI.[40] Because key Texas Rules of Evidence mirror the Federal Rules of Evidence (or have similar provisions), a review of these discussions is instructive.

A helpful overview of how Artificial Intelligence as evidence is complex and challenging is described in a 2021 article by Judge Paul Grimm and Professors Maura Grossman and Gordon Cormack, *Artificial Intelligence as Evidence*.[41]

Under FRE 901(a), "To satisfy the requirement of authenticating or identifying an item of evidence, the proponent must produce evidence sufficient to support a finding that the item is what the proponent claims it is." A proponent of this evidence can satisfy the low burden of authenticating by providing evidence to show that the item is what the proponent claims it is. The Federal Rules of Evidence Advisory Committee discussions include consideration of how this low burden might not be sufficient to address admission of AI.

Rule 901(b) sets out a non-exhaustive list of examples of how a proponent can demonstrate that the 901(a) showing is met. "The examples that most readily lend themselves to authenticating AI evidence are: Rule 901(b)(1) (testimony of a witness with knowledge that an item is what it is claimed to be); and Rule 901(b)(9) (evidence describing a process or system and showing that it produces an accurate result)."[42]

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[40] *See*, Federal Rules of Evidence Advisory Committee October 10, 2023 Agenda Book(Agenda Book) at 84

[41] Grimm, Grossman and Cormack, *Artificial Intelligence as Evidence*, 19 Nw. J. Tech. & Intellectual Property 9 (December, 2021)

[42] *Id* at26.

A witness called to authenticate AI evidence under Rule 901(b)(1) must also comply with other applicable rules, including Rule 602 that requires the authenticating witness to have personal knowledge of how the AI technology functions.[43] Due to the often-opaque nature of AI tools deployed in a business setting, it could be quite difficult for a witness to demonstrate personal knowledge.

> . . . AI applications seldom are the product of a single person possessing personal knowledge of all the facts that are needed to demonstrate that the technology and its output are what its proponent claims them to be. Data scientists may be required to describe the data used to train the AI system. Developers may be required to explain the features and weights that were chosen for the machine-learning algorithm. Technicians knowledgeable about how to operate the AI system may be needed to explain what they did when they used the tool, and the results that they obtained. These technicians, however, may be entirely at sea when asked to explain how the data was collected or cleansed, how the algorithm that underlies the AI system was programmed, or how the system was tested to show that it produces valid and reliable results.[44]

AI evidence could also be authenticated under Rule 901(b)(1) through the testimony of an expert qualified under Rules 702 and 703.

Authentication under Rule 901(b)(9) faces the same challenges as Rule 901(b)(1) regarding a witness who can testify either through personal knowledge or expert credentials to satisfy the requirement of Rule subsection (9).[45]

The Grimm, Grossman and Cormack article accurately describes the unique challenges with admitting AI evidence:

> An important feature of authentication needs careful consideration in connection with admitting AI evidence. Normally, a party has fulfilled its obligation to authenticate non-testimonial evidence by producing facts that are sufficient for a reasonable factfinder to conclude that the evidence more likely than not is what the proponent claims it is. In other words, by a mere preponderance. This is a relatively low threshold--51%, or slightly better than a coin toss. However, as we have shown in this paper, not all AI evidence is created equal. Some AI systems have been tested and shown to be valid and reliable. Others have not, when, for

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[43] *Id* at 26-27.

[44] *Id* at 27.

[45] "There are two additional rules of evidence that may be used to authenticate AI evidence that are closely related to Rules 901(b)(1) and 901(b)(9). They are Fed. R. Evid. 902(13), which allows authentication of "[a] record generated by an electronic process or system that produces an accurate result, as shown by a certification of a qualified person"; and Fed. R. Evid. 902(14), which allows authentication of "[d]ata copied from an electronic device, storage medium, or file, if authenticated by a process of digital identification, as shown by a certification of a qualified person." Rules 902(13) and (14) would allow the proponent of AI evidence to authenticate it by substituting the certificate of a qualified witness for their live testimony. But it must be stressed that the qualifications of the certifying witness and the details of the certification that the evidence produces an accurate and reliable result must be the same as would be required by the in-court testimony of a similarly qualified witness. Rules 902(13) and (14) are not invitations for boilerplate or conclusory assertions of validity and reliability and should not be allowed to circumvent the need to demonstrate, not simply proclaim, the accuracy and reliability of the system or process." *Id.* at Footnote 362. Texas does not have an analogous version of FRE 901(13) and (14), but Texas does have a similar method to self-authenticate business records (which conceptually include Gen AI output) through a Business Records Affidavit.

> example, efforts to determine their validity and reliability have been blocked by claims of proprietary information or trade secret. Furthermore, some of the tasks for which AI technology has been put to use can have serious adverse consequences if it does not perform as promised--such as arresting and criminally charging a person based on flawed facial recognition technology or sentencing a defendant to a long term of imprisonment based on an AI system that has been trained using biased or incomplete data that inaccurately or differentially predicts the likelihood that the defendant will reoffend.[46]

B. Deep-Fakes

In addition to the Federal Evidence Advisory Committee's focus on the relatively low burden of authentication of evidence is their concern that AI tools can be used to alter photographs, videos and other forms of evidence – often referred to as "Deep-Fakes".[47] The Reporter for the Evidence Advisory Committee, Professor Dan Capra, laid-out the challenges of Deep-Fakes and the potential gap in the Federal Rules of Evidence to enable trial court judges to determine whether certain offered evidence is authentic, particularly because "AI make deepfakes much more difficult to detect."[48]

Professor Capra further described the limitations of authentication of photos that might be altered under Rule 901(a):

> Under Rule 901(a), the standards of authenticity are low. The proponent must only "produce evidence sufficient to support a finding that the item is what the proponent claims it is. . . . The drafters of the rule believed that authenticity should generally be a jury question because, if a juror finds the item to be inauthentic, it just drops from the case, so no real damage is done; Rule 901 basically operates to prevent the jury from wasting its time evaluating an item of evidence that clearly is not what the proponent claims it to be[49]

Professor Capra explained the process of authentication of evidence under the Rule:

> The structure of the Rule is as follows: 1) subdivision (a) sets the general standard for authenticity—enough admissible evidence for a juror to believe that the proffered item is what the proponent says it is; 2) subdivision (b) provides examples of sufficient authentication; if the standard set forth in any of the illustrations is met, then the authenticity objection is overruled and any further question of authenticity is for the jury; and 3) the illustrations are not intended to be independent of each other, so a proponent can establish authenticity through a single factor or combination of factors in any particular case. Finally, it should be noted that Rule 902 provides certain situations in which the proffered item will be considered self-authenticating—no reference to any Rule 901(b) illustration need be made or satisfied if the item is self-authenticating.[50]

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[46] *Id* at 28.

[47] *See* Dixon, Judge Herbert B. Jr., *The "Deepfake Defense": An Evidentiary Conundrum,* ABA Journal, June 11, 2024. The "Deepfake Defense": An Evidentiary Conundrum (americanbar.org)

[48] 2023-10_evidence_rules_agenda_book_final_10-5.pdf (uscourts.gov) at 85

[49] *Id* at 87.

[50] *Id* at 87.

He noted the unique problem raised by the potential for deepfakes: "Applying the current authentication rules to deepfakes raises at least two concerns: 1. Because deepfakes are hard to detect, many deepfakes will probably satisfy the low standards of authenticity; and 2. On the other hand, the prevalence of deep fakes will lead to blanket claims of forgery, requiring courts to have an authenticity hearing for virtually every proffered video."

In its May 15, 2024 Report to the Committee on Rules of Practice and Procedure of the Judicial Conference of the United States (the Standing Committee)[51], the Advisory Committee on Evidence offered the following takeaways from its Panel Discussion on AI and Machine Learning:

> 1. Consideration should be given to a rule covering machine-learning output when it is not accompanied by an expert witness. One possibility is a new rule applying the Rule 702 reliability standards to such machine-learning data. The problems posed by machine learning data are not ones of authenticity but rather of reliability. One challenge, however, is to draft a rule on machine-learning evidence that will not cover basic, well-established machine-based data such as thermometers, radar guns, etc.
>
> 2. The problem of deepfakes is really one of forgery --- a problem that courts have dealt with under the existing rules for many years. This cautions against a special rule on deepfakes --- with the proviso that traditional means of authentication such as familiarity with a voice, and personal knowledge, might need to be tweaked because the authenticating witness may not be able to detect a deepfake.
>
> 3. An opponent should not have the right to an inquiry into whether an item is a deepfake merely by claiming that it is a deepfake. Some initial showing of a reason to think the item is a deepfake should be required. The question is whether a rule is necessary to establish the requirement of an initial showing of fakery. Courts currently require some kind of showing before inquiring into whether digital and social media evidence have been subject to hacking; it is not enough for an opponent to contend that the item is inauthentic because, you never know, it might have been hacked. And courts have imposed that initial requirement on the opponent without relying on a specific rule. The question for the Committee is whether a procedural rule to impose a burden of going forward on the opponent is necessary when it comes to deepfakes. Such a rule might be added to Rule 901 as a new Rule 901(c). Former Judge Paul Grimm and Dr. Maura Grossman proposed a Rule 901(c) that the Committee considered at the meeting. The Committee agreed that the proposal could not be adopted in its present form, because it required the opponent to show that it was more likely than not a fake, which seems too high for an initial burden. The Committee remains open to considering a rule that would impose on the opponent a burden of going forward when an item is challenged as a deepfake.
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> 4. It may be that the admissibility of machine-learning evidence could be dependent on validation studies, without the necessity of courts and litigants inquiring into source codes, algorithms, etc. Thought must be given, however, to how such validation studies

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[51] Standing Committee June 21, 2024 Agenda Book at 96

can be conducted, and how they are to be reviewed by courts.

C. Potential Amendments to T.R.E. 901 to Address AI

The Subcommittee suggests that the Texas State Bar Evidence Committee should discuss whether the current Texas Rules of Evidence on authentication appropriately account for AI generated information, particularly the risk that deep-fake evidence could be offered as evidence without any inquiry as to whether the information is what it appears to be. As described above, the structure of Rule 901 sets a relatively low hurdle for the proponent of evidence to meet authenticity requirements and does not clearly enable another party to challenge whether the evidence could have been altered by means of AI technology. Amending Rule 901(b)(9) as well as adding a new 901(c) arguably will impose a minor but important additional step to prove-up evidence that was generated by AI and further will enable litigants to bring challenges to the authenticity of any electronic evidence that could have been fabricated or altered.

The Subcommittee recommends that the Advisory Committee consider the Grimm and Grossman proposals to amend Rule 901(b)(9) and add Rule 901(c) enabling a challenge to authenticity of electronic evidence.[52]

Rule 901

(b) Examples. The following are examples only—not a complete list—of evidence that

satisfies the requirement:

. . .

(9) Evidence About a Process or System.

(A) Evidence describing a process or system and showing that it produces an accurate and reliable result and

(B) if the proponent concedes that the item was generated by artificial intelligence, additional evidence that:

(i) describes the software or program that was used; and

(ii) shows that it produced valid and reliable results in this instance.

. . .

901(c): Potentially Fabricated or altered electronic evidence.

If a party challenging the authenticity of computer-generated or other electronic evidence demonstrates to the court that a jury reasonably could find that it is more likely than not either fabricated, or altered in whole or in part, the evidence is admissible only if the proponent

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[52] *See* Appendix B, Judge Paul Grimm and Professor Maura Grossman: Proposed Modification of Current Rule 901(b)(9) for AI evidence and Proposed New Rule 901(c) for "Deepfake" Evidence (attached) and referenced in the Evidence Advisory Committee takeaways described above.

demonstrates that its probative value outweighs its prejudicial effect on the party challenging the evidence.

D. Rule 902(10) Business Records Affidavit and AI

Although not within the subject matter of the Court's Referral, the Subcommittee suggests that the State Bar Evidence Committee should consider whether Texas Rule of Evidence 902(10), Business Records Accompanied by Affidavit should be amended to reflect AI generated records because Business Records Affidavits could be used to authenticate AI generated records that generally would not meet the requirements for authenticity and reliability. As noted above in the discussion pertaining to Rule 901, AI generated records could be unreliable or falsified and otherwise might not be subject to authentication under Rule 901. However, use of a Business Records Affidavit to self-prove admissibility, by-passing evidence of authenticity could result in admission into evidence of AI generated content that is neither reliable nor authentic.

The Subcommittee recommends that the State Bar's Evidence Committee discuss amending Rule 902(10) to either exclude AI generated content from a Business Records Affidavit and instead follow the amended procedures for authentication of evidence under 901(b)(9).

VII. TRCP 226a Should be Amended and Updated

Texas Rule of Civil Procedure 226a sets out the instructions to be given to potential jurors when assigned to a jury venire as well as additional instructions given to jurors when they are seated on a jury. The Instructions were last updated in 2005 and include references to defunct technology. The Subcommittee suggests that the Rules 216-299a Subcommittee consider updating the instructions to reflect current technology as well as reference Generative AI.

Paragraph 3 of the Venire instructions and Paragraph 4 of the instructions to empaneled jurors are the same and could be updated as follows:

> Do not discuss this case with anyone, even your spouse or a friend, either in person or by any other means [including ~~by~~ but not limited to phone, text message, email, ~~message,~~ chat ~~room~~, , blog, or social networking electronic platforms and websites including apps such as Facebook, X (Twitter), Instagram, WhatsApp, Tik-Tok, or Slack ~~or Myspace~~]. Do not allow anyone to discuss the case with you or in your hearing. If anyone tries to discuss the case with you or in your hearing, tell me immediately. We do not want you to be influenced by something other than the evidence admitted in court.

Paragraph 1 of the instructions for seated jurors should also be revised as follows:

> 1. Turn off all phones and other electronic devices. While you are in the courtroom and while you are deliberating, do not communicate with anyone through any electronic device. [For example, do not communicate by phone, text message, email, message, chat ~~room~~, blog, or social networking websites such as Facebook, Instagram, WhatsApp, Tik-Tok, or Slack X (Twitter), Instagram, WhatsApp, Tik-Tok, or Slack ~~or Myspace~~][I will give you a number where others may contact you in case of an emergency.] Do not post information about the case on

the Internet before these court proceedings end and you are released from jury duty. Do not record or photograph any part of these court proceedings, because it is prohibited by law.

Additionally, Paragraph 6 of the instructions for seated jurors should be revised

6. Do not investigate this case on your own. For example, do not:

a. try to get information about the case, lawyers, witnesses, or issues from outside this courtroom;

b. go to places mentioned in the case to inspect the places;

c. inspect items mentioned in this case unless they are presented as evidence in court;

d. look anything up in a law book, dictionary, or public record to try to learn more about the case;

e. look anything up on the Internet or by using generative artificial intelligence tools to try to learn more about the case; or

f. let anyone else do any of these things for you.

This rule is very important because we want a trial based only on evidence admitted in open court. Your conclusions about this case must be based only on what you see and hear in this courtroom because the law does not permit you to base your conclusions on information that has not been presented to you in open court. All the information must be presented in open court so the parties and their lawyers can test it and object to it. Information from other sources, like the Internet or generative artificial intelligence tools, will not go through this important process in the courtroom. In addition, information from other sources could be completely unreliable. As a result, if you investigate this case on your own, you could compromise the fairness to all parties in this case and jeopardize the results of this trial.

Appendix A
Backgrounder on AI and Resources

AI is a broad term that includes different elements of computer technology that is used to simulate or create intelligent behavior or thought in a computer. Definitions vary, but the definition from the Organization for Economic Co-operation and Development (OECD) has gained traction: "An AI system is a machine-based system that, for explicit or implicit objectives, infers, from the input it receives, how to generate outputs such as predictions, content, recommendations, or decisions that can influence physical or virtual environments. Different AI systems vary in their levels of autonomy and adaptiveness after deployment."[53] Recent rapid-fire developments in the AI landscape, particularly tools such as ChatGPT, have materially changed the potential uses and opportunities to abuse AI tools. AI is now becoming a tool used by businesses to improve efficiency and assist in decision-making. AI supported tools perform detailed analytics and even create computer programming. The ostensible purpose of AI technologies is to enhance our collective efficiency. Just as the Industrial Revolution heralded the replacement of human labor with automation, an AI-led transformation using powerful algorithms could save millions of hours of cognitive processing time.[54]

Many forms of AI have been in use for over 35 years, including the IBM Watson computer that played chess against masters. The AI landscape materially changed however on November 30, 2022, when ChatGPT was released to the public. Over 1 million users used the tool within the first 5 days and within the first three months, over 100,000,000 users across the globe were actively using the tool.

To understand the landscape of potential uses of AI, it is important to describe the different types of AI tools and their use cases. This chart[55] describes the progression of AI toolsets.

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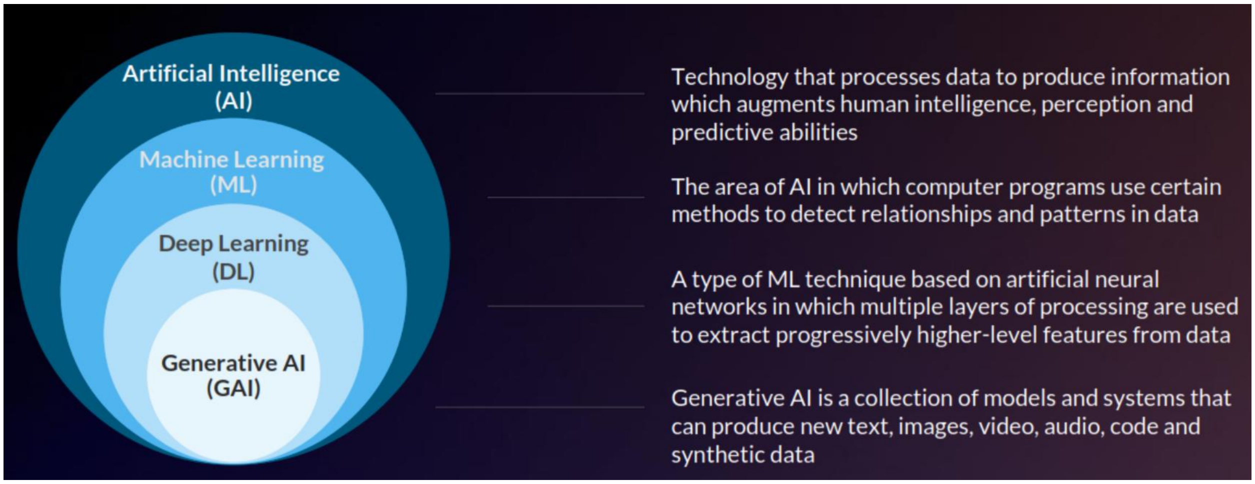
[53] What is AI? Can you make a clear distinction between AI and non-AI systems? - OECD.AI

[54] AI-and-Access-to-Justice-Final-White-Paper.pdf (nacmnet.org) at 1.

[55] Courtesy of Christy Hawkins, akerman



Technology that processes data to produce information which augments human intelligence, perception and predictive abilities

The area of AI in which computer programs use certain methods to detect relationships and patterns in data

A type of ML technique based on artificial neural networks in which multiple layers of processing are used to extract progressively higher-level features from data

Generative AI is a collection of models and systems that can produce new text, images, video, audio, code and synthetic data

Generative AI tools are often powered by Large Language Models (called LLMs) which are composed of huge volumes of data resources that are used by the engine to learn and respond to inputs. ChatGPT reportedly was trained on a dataset of over 300 billion words with a total data size of approximately 570 gigabytes of information. Another measure of the power of a LLM is the number of parameters created in the tool from learned information in the data set. ChatGPT is estimated to currently have hundreds of billions of parameters and growing.

Generative AI raises particularly unique concerns as it creates context, including text and images, without any human interaction. A Large Language Model is reliable only to the extent of the validity of the sourced data set; LLMs do not have the inherent ability to discern whether its source data is reliable or factually accurate. If the LLM does not have full access to all available information (for example if certain news sites are not included in the LLM), the output could be incomplete. Additionally, LLMs are also subject to the biases of the feedback provided by the developers who provide training data; some LLMs can be more prone to offer output consistent with the views (including subconscious biases) of its programmers. A more pernicious problem is that Generative AI is subject to 'hallucinations' which are inaccurate sentences or phrases contained in AI responses to queries.[56] "[G]enerative A.I. . . . relies on a complex algorithm that analyzes the way humans put words together on the internet. It does not decide what is true and what is not. . . . The tech industry often refers to the inaccuracies as 'hallucinations.'"[57] There is no technology currently available that can eliminate this risk.[58]

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[56] *See* Karen Weise & Cade Metz, When A.I. Chatbots Hallucinate, N.Y. Times (last updated May 9, 2023) https://www.nytimes.com/2023/05/01/business/ai-chatbots-hallucination.html

[57] *Id.*

[58] *Id.*

Appendix B

Proposed Modification of Current Rule 901(b)(9) for AI evidence and Proposed New Rule 901(c) for "Deepfake "Evidence

By Paul W. Grimm & Maura R. Grossman

[901](b) **Examples**. The following are examples only—not a complete list—of evidence that satisfies the requirement [of Rule 901(a)]:

(9) *Evidence about a Process or System*. For an item generated by a process or system:

(A) evidence describing it and showing that it produces ~~an accurate~~ **a reliable** result; and

(B) if the proponent concedes that the item was generated by artificial intelligence, additional evidence that:

(i) describes the software or program that was used; and

(ii) shows that it produced valid and reliable results in this instance.

Proposed New Rule 901(c) to address "Deepfakes"

901(c): *Potentially Fabricated or altered electronic evidence.*

If a party challenging the authenticity of computer-generated or other electronic evidence demonstrates to the court that a jury reasonably could find that it is more likely than not either fabricated, or altered in whole or in part, the evidence is admissible only if the proponent demonstrates that its probative value outweighs its prejudicial effect on the party challenging the evidence.

Rationale:

Given the complexities and challenges presented by artificial intelligence generated evidence, a new rule that sets a standard for what is sufficient to authenticate such evidence would be extremely helpful. Because AI generated evidence is, by definition, evidence produced by a system or process, the proposal is to add a subsection (B) to existing 901(b)(9) to set a standard for authenticating evidence that the proponent acknowledges is AI generated. The proposed revision substitutes the word "reliable" for "accurate" in existing rule 901(b)(9), because evidence can be "accurate" in some instances but inaccurate in others (such as a broken watch, which "accurately" tells the time twice a day but is not a reliable means of checking the time otherwise).

For acknowledged AI generated evidence, the proposed new rule would identify a sufficient means for authentication of AI generated evidence. It requires the proponent to (i) describe the software or program that was used to create the evidence, and (ii) show that it produced *valid* and *reliable* results in the particular case in which it is being offered. Valid evidence is evidence that produces accurate results, reliable evidence is that which produces consistently accurate results when applied to similar facts and circumstances. Both are required to ensure authenticity of AI generated evidence.

A separate rule is required to address the relatively recent phenomenon of AI generated “deepfakes”, which, due to rapidly improving generative AI software applications, are capable of producing fabricated (or altering existing) photographs, audio recordings, and audio-visual recordings that are so realistic that it is becoming very difficult to differentiate between authentic evidence and fabricated/altered evidence. A separate rule is needed for such fake evidence, because when it is offered the parties disagree about the nature of the evidence. The opposing party challenges the authenticity of the evidence and claims that it is AI generated fakery, while the proponent insists that it is not AI generated, but instead that it is simply an electronic photograph (for example, one taken on a “smart phone”), or a voice recording (such as one left on voice mail) or audio-visual recording (such as one taken with a “smart phone” or digital camera). Because the parties fundamentally disagree about the very nature of the evidence, the proposed rule for authenticating acknowledged AI generated evidence will not work. A separate rule is required.

The proposed new rule creates a new rule 901(c). That is because the proponent of evidence challenged as AI generated fakery may be authenticated by many means other than Rule 901(b)(9), which focuses on evidence generated by a “system or process”. The proponent might choose to authenticate an audio recording under Rule 901(b)(5) (opinion as to voice) or Rule 901(b)(3) (comparison of evidence known to be authentic with other evidence the authenticity of which is questioned).

The proposed rule does not use the word “deepfake”, because it is not a technical term, but instead describes the evidence as being either computer-generated (which encompasses AI-generated evidence) or electronic evidence, which encompasses other forms of electronic evidence that may not be AI generated (such as digital photographs, or digital recordings).

The proposed rule puts the initial burden on the party challenging the authenticity of computer generated/electronic evidence as AI generated fakery to make a showing to the court that a jury reasonably could find (but is not required to find) that it is more likely than not either fabricated or altered in whole or part. This approach recognizes that the facts underlying whether the evidence is authentic or fake may be challenged, in which case the judge’s role under Rule 104(a) is limited to preliminarily evaluating the evidence supporting and challenging authenticity, and determining whether a reasonable jury could find more likely than not that the challenged evidence is fake. If the answer is “yes” then, pursuant to Rule 104(b), the judge ordinarily would be required to submit the evidence to the jury under the doctrine of relevance conditioned upon a finding of fact, Rule 104(b).

But deepfakes increasingly are getting so hard to detect, and often can be so graphic or have such impact that the jury may be unable to “ignore” the content of generative AI (GAI) shown to be fake once they have seen it. See generally Taurus Myhand, *Once The Jury Sees It, The Jury Can’t Unsee It: The Challenge Trial Judges Face When Authenticating Video Evidence in The Age of Deepfakes*, 29 Widener L. Rev. 171, 174-5, 2023 (“The dangerousness of deepfake videos lie in the incomparable impact these videos have on human perception. Videos are not merely illustrative of a witnesses’ testimony, but often serve as independent sources of substantive information for the trier of fact. Since people tend to believe what they see, ‘images and other forms of digital media are often accepted at face value.’ ‘Regardless of what a person says, the ability to visualize something is uniquely believable’. Video evidence is more cognitively and emotionally arousing to the trier of fact, giving the impression that they are observing activity or events more directly.” Internal citations omitted).

If the judge is required by Rule 104(b) to let the jury decide if audio, visual, audiovisual, or pictural evidence is genuine or fake when there is evidence supporting each outcome, they are then in danger of being exposed to evidence that they cannot "unremember" even if they doubt that it is fake. This presents an issue of potential prejudice that ordinarily would be addressed under Rule 403. But Rule 403 assumes that the evidence is "relevant" in the first instance, and only then can the judge weigh its probative value against the danger of unfair prejudice. But when the very question of relevance turns on resolving disputed evidence, the current rules of evidence create an evidentiary "Catch 22"—the judge must let the jury see the disputed evidence on authenticity for their resolution of the authenticity challenge, but that exposes them to a new type of evidence that may irrevocably alter their perception of the case even if they find it to be inauthentic.

The proposed new rule 901(c) solves the "Catch 22" problem. It requires the party challenging the evidence as fake to demonstrate to the judge that a reasonable jury could find that the challenged evidence more likely than not is fake. The judge is not required to make the finding that it is, only that a reasonable jury could so find by a preponderance of evidence. This is similar to the approach that the Supreme Court approved regarding Rule 404(b) evidence in *Huddleston v. U.S.*, [cite], and the Third Circuit approved regarding Rule 415 evidence in *Johnson v. Elk Lake School District*. [cite].

Under the proposed new rule, if the judge makes this preliminary finding, it then they would be permitted to exclude it (without sending it to the jury) if the proponent of the evidence cannot show that its probative value exceeds its prejudicial impact. This is a fairer balancing test than Rule 403, which leans strongly towards admissibility. Further, the proposed new balancing test already is recognized as an appropriate in other circumstances. See, e.g. Rule 609(a)(1)(B).

The proposed new rule has other advantages as well. While it requires the party challenging the evidence as a deepfake to demonstrate facts (not conclusory or speculative arguments) from which the judge could find that a reasonable jury *could* more likely than not find it to be fake, this does not require them to persuade the judge that it actually is fake, which lessens the burden on the challenging party to make a sufficient initial challenge. Under an approach already recognized in *Huddleston* and *Johnson*, the proposed new rule only requires the judge to determine whether a jury reasonably could find it to be fake, at which time the proponent would be required to show that the probative value of the evidence was greater than its prejudicial impact. This determination would be made by the judge, as Rule 609(a)(1)(B) already permits.

The proposed rule also has the benefit of not imposing any initial obligation on the proponent of the evidence to authenticate it in any particular way. The proponent can choose from any authentication methods illustrated by Rules 901(b) and 902, or any other means of showing that it is what it purports to be. If, under the proposed rule, the party challenging the evidence as a deepfake then succeeds in showing the judge that a jury reasonably could find the challenged evidence to be fake, the proponent would have the opportunity to bolster the authenticating evidence, and the judge would then apply the new balancing test. This fairly allocates the initial burden on the challenging party, the responding burden of the proponent, and the role of the judge in screening for unfair prejudice without the need to send the disputed facts to the jury.

Appendix C
Artificial Intelligence Resources

State Court Orders, Rules, and AI Rules Trackers

Texas House Bill 2060 (88R) that created the Artificial Intelligence Advisory Council which is co-chaired by Senator Tan Parker and Representative Gio Capriglione.

Texas - TX R BEXAR CTY LOC RULES DIST CT Rule 3 - Nonjury Docket

Connecticut Judicial Branch -The Judicial Branch's Policies and Procedures Concerning Artificial Intelligence

Statement of Principles for the New Jersey Judiciary's Ongoing Use of Artificial Intelligence, Including Generative Artificial Intelligence

Notice – Legal Practice: Preliminary Guidelines on the Use of Artificial Intelligence by New Jersey Lawyers

Utah, Interim Rules on the Use of Generative AI, October 25, 2023

Kansas Office of Information Technology Services, Generative Artificial Intelligence Policy

National Conference of State Legislatures - Artificial Intelligence 2023 Legislation

Eastern District of Texas GO 23-11 Amending Local Rules Effective December 1, 2023.pdf (uscourts.gov)

Legal Research

Artificial Intelligence Court Rules | Westlaw Edge

ARTICLE: Rule 11 Is No Match for Generative AI, 27 Stan. Tech. L. Rev. P308

Resource: AI Orders | Responsible AI in Legal Services (rails.legal) Court Rules Tracker - Federal and State Courts

Tab D

MEMORANDUM

TO: Richard Orsinger, Chair of SCAC Subcommittee on Rules 15-165A
Judge Ana Estevez, 251st District Court of Potter County, Texas

FROM: Executive Committee, Family Law Council

SUBJECT: Proposed Rule Changes to Texas Rule of Civil Procedure 13 & Texas Rule of Evidence 901

DATE: August 6, 2024

I
SUMMARY

The Texas Supreme Court is charged with addressing changes to the Texas Rules of Civil Procedure 13 and Texas Rule of Evidence 901. It has asked the Supreme Court Advisory Committee (SCAC) to examine the existing rule and suggest recommendations. At the request of Richard Orsinger, Chair of the SCAC Subcommittee on Rules 15-165a, the Family Law Council has reviewed this matter and provides the comments in this Memorandum for the benefit of his committee and SCAC as a whole.

II
COMMENTS

It seems that many of the problems arising from the implementation of artificial intelligence in the legal system relate directly to the issues of education and training. Education, training, and lawyer competency will go a long way toward solving these issues. In contrast to past precedence, a problem appears to be developing in that solo and small-firm practitioners are not adopting the AI technology as they have with other innovative technologies. Further, most lawyers are afraid of the technology. This does not begin to address how the public will use the technology, as we are still at the early adopter stage. We are learning and adopting as we implement the technology, so a review of these rules is warranted. We have been educated that Model Rule 1.1 obligates lawyers to provide competent representation to clients. MODEL RULES R. 1.1 & cmt. [8]. *See also* ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 477R, at 2–3 (2017) [hereinafter ABA Formal Op. 477R] (discussing the ABA's "technology amendments" made to the Model Rules in 2012). This duty requires lawyers to exercise the "legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation," as well as to understand "the benefits and risks associated" with the technologies used to deliver legal services to clients.

With the ability to quickly create new, human-crafted content in response to user prompts, Generative Artificial Intelligence (GAI) tools offer lawyers the potential to increase the efficiency and quality of their legal services to clients. Lawyers must also recognize inherent risks with the technology. It may combine otherwise accurate information in unexpected ways to yield false or inaccurate results. Karen Weise & Cade Metz, *When A.I. Chatbots Hallucinate*, N.Y. TIMES (May 1, 2023). Some GAI tools are also prone to "hallucinations," providing ostensibly plausible responses that have no basis in fact or reality. Ivan Moreno, *AI Practices Law 'At the Speed of Machines.' Is it Worth It?*, LAW360 (June 7, 2023); *See* Varun Magesh, Faiz Surani, Matthew Dahl, Mirac Suzgun, Christopher D. Manning, & Daniel E. Ho, *Hallucination Free? Assessing the Reliability of Leading AI Legal Research Tools*, STANFORD UNIVERSITY (June 26, 2024), *available at* https://dho.stanford.edu/wp-content/uploads/Legal_RAG_Hallucinations.pdf (study finding leading legal research companies' GAI systems "hallucinate between 17% and 33% of the time").

ISSUE ONE: Should Texas Rule 13 be amended to account for the use and misuse of artificial intelligence technology?

DISCUSSION:

The State Bar of Texas's Taskforce for Responsible AI in Law (TRAIL) issued an interim report recommending potential changes to the Texas Rules of Civil Procedure 13. It should be noted that while issues are identified, the report does not give specific and identifiable changes in the rule itself. The report notes that Texas Rule of Civil Procedure 13 would be evaluated to determine whether additional language or guidance in necessary to provide Texas lawyers with additional information regarding AI-generated misinformation or hallucinations, and to provide Texas Judges with adequate remedies regarding the same.

One concern is that non-lawyer, pro se litigants are not subject to the Rules of Professional Conduct, but they remain subject to Tex. R. Civ. P. 13. The current version of Rule 13 requires that the pro se litigant certify, to the best of his/her knowledge, that the pleading is groundless and false in advance of the filing of a motion. The Texas Supreme Court Rules Advisory Committee may wish to consider whether Rule 13 should be modified.

Texas Rule of Civil Procedure 13 provides:

Rule 13 Effect of Signing of Pleadings, Motions and Other Papers; Sanctions

The signatures of attorneys or parties constitute a certificate by them that they have read the pleading, motion, or other paper; that to the best of their knowledge, information, and belief formed after reasonable inquiry the instrument is not groundless and brought in bad faith or groundless and brought for the purpose of harassment. Attorneys or parties who shall bring a fictitious suit as an experiment to get an opinion of the court, or who shall file any fictitious pleading in a cause for such a purpose, or shall make statements in pleading which they know to be groundless and false, for the purpose of securing a delay of the trial of the cause, shall be held guilty of a contempt. If a pleading, motion or other paper is signed in violation of this rule, the court, upon motion or upon its own initiative, after notice and hearing, shall impose an appropriate sanction available under Rule 215,[1] upon the person who signed it, a represented party, or both. Courts shall presume that pleadings, motions, and other papers are filed in good faith. No sanctions under this rule may be imposed except for good cause, the particulars of which must be stated in the sanction order. “Groundless” for purposes of this rule means no basis in law or fact and not warranted by good faith argument for the extension, modification, or reversal of existing law. A general denial does not constitute a violation of this rule. The amount requested for damages does not constitute a violation of this rule.

COMMENTS:

First, for the lawyers, while we await the ethics opinion from the Committee on Professional Responsibility in Texas, the American Bar Association issued Formal Ethics Opinion 512 on July 29, 2024 which may offer some guidance. Likewise, the 5th Circuit Federal Court of Appeals has also recently grappled with this issue. ABA Opinion 512 explains, “Lawyers using GAI in litigation have ethical responsibilities to the courts as well as to clients. Model Rules 3.1, 3.3, and 8.4(c) may be implicated by certain uses. Rule 3.1 states, in part, that “[a] lawyer shall not bring or defend a proceeding, or assert or controvert and issue therein, unless there is a basis in law or fact for doing so that is not frivolous.” Rule 3.3 makes it clear that lawyers cannot knowingly make any false statement of law or fact to a tribunal or fail to correct a material false statement of law or fact previously made to a tribunal.45 Rule 8.4(c) provides that a lawyer shall not engage in “conduct involving dishonesty, fraud, deceit or misrepresentation.” Even an unintentional misstatement to a court can involve a misrepresentation under Rule 8.4(c). Therefore, output from a GAI tool must be carefully reviewed to ensure that the assertions made to the court are not false. Issues that have arisen to date with lawyers’ use of GAI outputs include citations to nonexistent opinions, inaccurate analysis of authority, and use of misleading arguments. Some courts have responded by requiring lawyers to disclose their use of GAI. As a matter of competence, as previously discussed, lawyers should review for accuracy all GAI outputs. In judicial proceedings, duties to the tribunal likewise require lawyers, before submitting materials to a court, to review these outputs, including analysis and citations to authority, and to correct errors, including misstatements of law and fact, a failure to include controlling legal authority, and misleading arguments.” Am. Bar Ass'n Standing Comm. on Ethics & Prof'l Responsibility, Formal Op. 512 (2024).

Previously the 5th Circuit sought to address this issue by considering the following proposed amendment to 5th Cir. R. 32.3.:

Fifth Circuit Rule 32.3 32.3. Certificate of Compliance. See Form 6 in the Appendix of Forms to the Fed. R. App. P. Additionally, counsel and unrepresented filers must further certify that no generative artificial intelligence program was used in drafting the document presented for filing, or to the extent such a program was used, all generated text, including all citations and legal analysis, has been reviewed for accuracy and approved by a human. A material misrepresentation in the certificate of compliance may result in striking the document and sanctions against the person signing the document.

There was also a proposal to change the certificate of compliance to add:

3. This document complies with the AI usage reporting requirement of 5th Cir. R. 32.3 because: ☐ no generative artificial intelligence program was used in the drafting of this document, or ☐ a generative artificial intelligence program was used in the drafting of this document and all generated text, including all citations and legal analysis, has been reviewed for accuracy and approved by a human.

The court sought comments through January 4, 2024. In June 2024, the Court decided not to adopt a special rule saying:

United States Court of Appeals FIFTH JUDICIAL CIRCUIT

Court Decision on Proposed Rule

"The court, having considered the proposed rule, the accompanying comments, and the use of artificial intelligence in the legal practice, has decided not to adopt a special rule regarding the use of artificial intelligence in drafting briefs at this time. Parties and counsel are reminded of their duties regarding their filings before the court under Federal Rule of Appellate Procedure 6(b)(1)(B). Parties and counsel are responsible for ensuring that their filings with the court, including briefs, shall be carefully checked for truthfulness and accuracy as the rules already require. "I used AI" will not be an excuse for an otherwise sanctionable offense." U.S. Court of Appeals for the 5th Circuit, Court Decision on Proposed Rule Change (2024), https://www.ca5.uscourts.gov/docs/default-source/default-document-library/court-decision-on-proposed-rule.pdf?sfvrsn=5967c92d_2.

"If the rule had been adopted, the Fifth Circuit would've been the first US appeals court to create a special rule on AI. Some US district judges, including a few within the Fifth Circuit's jurisdiction, have issued their own rules about lawyers using AI in their courts. US District Judge Brantley Starr in the Northern District of Texas appeared to be the first to issue such an order last year, warning that the platforms are currently "prone to hallucinations and bias." At an April panel, Starr said he'd be willing to roll back his standing order if the flaws of AI are more generally known." Jacqueline Thomsen, Fifth Circuit Won't Adopt AI Rule After Attorney Pushback, Bloomberg Law (June 11, 2024, 9:19 AM CDT), https://news.bloomberglaw.com/us-law-week/fifth-circuit-wont-adopt-ai-rule-after-attorney-pushback.

"But I do think there will be a point in time in which maybe my certification isn't needed," the judge said at the time. "Maybe if we all generally know about AI and bias and hallucination, and know what we should use it for and what we shouldn't, then I'll peel my certification back." Id.

The problem is that, while lawyers are covered under the rules of ethics, pro-se parties are not. Therefore, the phrase "to the best of their knowledge" becomes problematic. A non-represented person may say that, to the best of their knowledge, they relied on a third-party Generative AI tool. A solution would be to add a clarification to the current Rule 13.

One suggestion would be the following:

Rule 13 Effect of Signing of Pleadings, Motions and Other Papers; Sanctions

The signatures of attorneys or parties constitute a certificate by them that they have read the pleading, motion, or other paper; that to the best of their knowledge, information, and belief formed after reasonable inquiry the instrument is not groundless and brought in bad faith or groundless and brought for the purpose of harassment. Attorneys or parties who shall bring a fictitious suit as an experiment to get an opinion of the court, or who shall file any fictitious pleading in a cause for such a purpose, or shall make statements in pleading which they know to be groundless and false, for the purpose of securing a delay of the trial of the cause, shall be held guilty of a contempt. If a pleading, motion or other paper is signed in violation of this rule, the court, upon motion or upon its own initiative, after notice and hearing, shall impose an appropriate sanction available under Rule 215,[1] upon the person who signed it, a represented party, or both. ***The use of Artificial Intelligence or a Generative Artificial Intelligence Tool will not be an excuse for an otherwise sanctionable offense.*** Courts shall presume that pleadings, motions, and other papers are filed in good faith. No sanctions under this rule may be imposed except for good cause, the particulars of which must be stated in the sanction order. "Groundless" for purposes of this rule means no basis in law or fact and not warranted by good faith argument for the extension, modification, or reversal of existing law. A general denial does not constitute a violation of this rule. The amount requested for damages does not constitute a violation of this rule.

This clarification, along with increased continuing education for attorneys regarding the dangers and risks associated with the technology, and a statement such as the one from the 5th Circuit educating the public, will be a good start to essentially updating the rule for the current technology. It also serves as a reminder that truthfulness in the court system and justice are not just goals but requirements.

ISSUE TWO: Texas Rule of Civil Procedure 13 places the burden of proof on the filer, while Chapters 9 and 10 of the Texas Civil Practices & Remedies Code require reasonable diligence from the filer. Should the rules be clarified in light of the advent of artificial intelligence technology?

DISCUSSION:

The Taskforce for Responsible AI in Law Report references that the Artificial Intelligence (“AI”) Summit Attendees discussion resulted in the following recommendation:

For attorneys using AI, Texas Rule of Civil Procedure 13 places the burden of proof on the filer to ensure they understand what they are doing, while Chapters 9 and 10 of the Texas Civil Practice & Remedies Code (“CPRC”) require reasonable diligence from the filer. The Supreme Court's Rules Committee should clarify the rules without being specific to AI and GAI. The Rules provide the following:

§ 9.011. Signing of Pleadings

The signing of a pleading as required by the Texas Rules of Civil Procedure constitutes a certificate by the signatory that to <u>the signatory's best knowledge, information, and belief, formed after reasonable inquiry,</u> the pleading is not:

(1) groundless and brought in bad faith;

(2) groundless and brought for the purpose of harassment; or

(3) groundless and interposed for any improper purpose, such as to cause unnecessary delay or needless increase in the cost of litigation.

§ 9.012. Violation;

(a) At the trial of the action or at any hearing inquiring into the facts and law of the action, after reasonable notice to the parties, the court may on its own motion, or shall on the motion of any party to the action, determine if a pleading has been signed in violation of any one of the standards prescribed by Section 9.011.

(b) In making its determination of whether a pleading has been signed in violation of any one of the standards prescribed by Section 9.011, the court shall take into account:

(1) the multiplicity of parties;

(2) the complexity of the claims and defenses;

(3) the length of time available to the party to investigate and conduct discovery; and

(4) affidavits, depositions, and any other relevant matter.

(c) If the court determines that a pleading has been signed in violation of any one of the standards prescribed by Section 9.011, the court shall, not earlier than 90 days after the date of the determination, at the trial or hearing or at a separate hearing following reasonable notice to the offending party, impose an appropriate sanction on the signatory, a represented party, or both.

(d) The court may not order an offending party to pay the incurred expenses of a party who stands in opposition to the offending pleading if, before the 90th day after the court makes a determination under Subsection (a), the offending party withdraws the pleading or amends the pleading to the satisfaction of the court or moves for dismissal of the pleading or the offending portion of the pleading.

(e) The sanction may include one or more of the following:

(1) the striking of a pleading or the offending portion thereof;

(2) the dismissal of a party; or

(3) an order to pay to a party who stands in opposition to the offending pleading the amount of the reasonable expenses incurred because of the filing of the pleading, including costs, reasonable attorney's fees, witness fees, fees of experts, and deposition expenses.

(f) The court may not order an offending party to pay the incurred expenses of a party who stands in opposition to the offending pleading if the court has, with respect to the same subject matter, imposed sanctions on the party who stands in opposition to the offending pleading under the Texas Rules of Civil Procedure.

(g) All determinations and orders pursuant to this chapter are solely for purposes of this chapter and shall not be the basis of any liability, sanction, or grievance other than as expressly provided in this chapter.

(h) This section does not apply to any proceeding to which Section 10.004 or Rule 13, Texas Rules of Civil Procedure, applies

§ 10.001. Signing of Pleadings and Motions

The signing of a pleading or motion as required by the Texas Rules of Civil Procedure constitutes a certificate by the signatory that to the signatory's best knowledge, information, and belief, formed after reasonable inquiry:

(1) the pleading or motion is not being presented for any improper purpose, including to harass or to cause unnecessary delay or needless increase in the cost of litigation;

(2) each claim, defense, or other legal contention in the pleading or motion is warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law;

(3) each allegation or other factual contention in the pleading or motion has evidentiary support or, for a specifically identified allegation or factual contention, is likely to have evidentiary support after a reasonable opportunity for further investigation or discovery; and

(4) each denial in the pleading or motion of a factual contention is warranted on the evidence or, for a specifically identified denial, is reasonably based on a lack of information or belief.

COMMENTS:

As in the discussion of Rule 13, the concern is the vagueness of the phrase "best knowledge, information, belief, and after reasonable inquiry." Will a lawyer or a member of the public say that they used a Generative Artificial Intelligence tool and, therefore, their work was to their best knowledge and belief?

Texas Rule 9.012 could be clarified to add: *The use of Artificial Intelligence or a Generative Artificial Intelligence Tool will not be an excuse for an otherwise sanctionable offense.*

ISSUE THREE: Should Texas Rule of Evidence 901 be amended in light of concerns about the authenticity of evidence, specifically referring to deep fakes or AI-generated audio or video technology?

DISCUSSION:

As explained in the TRAIL report, Texas family law attorneys tend to be early adopters of technology due to the fast-paced nature of their field and the high volume of cases requiring professional efficiency. With over 85% of Americans using smartphones, digital media such as audio recordings, emails, texts, social media posts, and GPS data have become essential in family law cases. Handling these extensive and voluminous personal records is a critical aspect of family law practice.

However, the emotionally charged nature of family law and the inherent lack of trust between parties lead to the misuse of digital data. A significant evidentiary concern arises from "deepfakes," where AI platforms alter existing audio or video to make it appear as though an individual said or did something they did not. This rapidly improving technology complicates authenticating real evidence. Opponents of authentic videos may allege that they are deepfakes to exclude them from evidence or to sow doubt in the jury's minds.

This situation may lead to a "reverse CSI effect," where jurors expect sophisticated technology to prove the authenticity of a video. If juries begin to doubt the ability to determine what is real, their skepticism could undermine the justice system. Although technology to detect deepfakes is being developed, and government regulation and consumer warnings may help, proving or disproving the authenticity of evidence through expert testimony will incur significant costs.

In cases where a party challenges an exhibit as a deepfake or inauthentic, judges should consider holding a pretrial hearing to evaluate the parties' arguments and any expert testimony.

The TRAIL report also detailed the concerns with evidence in the digital age.

Potential Risks While the potential benefits are numerous, so too are the risks of misuse and abuse. Family law lawyers must be able to anticipate, identify, and respond to these situations.

1. **Falsified Records:** Free AI websites can easily create fake, manipulated, forged, and pseudo documents and records that frequently escape detection. Government records (passports, driver's licenses, search warrants, protective orders, deportation orders) and personal records (medical, drug tests, utility bills, real estate documents, bank statements) can be obtained in seconds, for a minimal cost. Fake emails, texts, audio recordings, and social media posts may be indistinguishable to a nonexpert without the application of AI-detecting software.
2. **Medical Lay Opinions:** Parental observation and opinion of their child's medical, mental, and emotional condition are commonly admitted in family law hearings. The basis for these opinions is explored on voir dire or during cross-examination to test the credibility of the parent's testimony. Parents often report relying on input from the children's treating physicians. However, as AI chatbots replace personal interactions with medical professionals, opinions based on doctors' recommendations may be deemed unreliable. This is exacerbated by the recent trend of AI systems being quietly trained by unsophisticated workers to anthropomorphize communications—emoting to show seemingly real empathy and thus soothe frightened patients. Mimicry of empathy and humanity by AI can manipulate human emotion and sway outcomes in imperceptible ways.
3. **Editing of Digital Media:** "Deep fakes" are fictitious digital images and videos. They are created with simple, free apps currently available on both Apple and Android smartphones. With a few clicks or taps, AI can manipulate digital media and create seemingly authentic photos and videos that easily fool unwary recipients. AI detectors flag suspicious files, but they are not foolproof. Attorneys should routinely run all digital photos through AI detectors.
4. **Caller ID Spoofing:** Spoofing is the falsification of information transmitted to a recipient phone's display that disguises the identity of the caller. The technique enables the user to impersonate others by changing the incoming phone number

shown on the receiving phone. In this way, someone can fabricate abusive, repeated, or harassing calls and texts seemingly originating from one spouse, parent, paramour, child, law enforcement, or CPS. The perpetrator can create a mountain of false evidence while hiding behind AI anonymity. AI systems can be instructed to inundate a recipient with nonstop harassing messages or calls, without leaving any digital footprint on the perpetrator's phone or computer. By evaluating years of messages and emails, the AI system can mimic the victim's speech and emoji patterns—a key element of admissibility. Further, AI spoofers can be used to fraudulently obtain or circumvent liability for life-long protective orders under Tex. Code Crim. Pro. 7b for stalking by digital harassment. And because these systems do not work through the service provider, third-party discovery from the phone company will appear to confirm that the calls or messages originated from the spoofed number, lending an air of credibility to the ruse.

5. **Voice Cloning:** Voice cloning apps and websites allow someone to convincingly spoof the voice of any other person with only a single audio sample of the target. Someone with dozens of voicemails and recorded conversations from years of marriage, or even a recorded deposition, can use these systems to create audio files that require an AI detector or forensic expert to detect.
6. **Data Analysis Manipulation:** AI systems can be used to subtly modify large data sets, corrupt legitimate data analysis, and generate false conclusions that appear legitimate and are only detectable by competing expert review. They can fabricate peer review and approval, circumventing the rigorous gatekeeping process that would otherwise be required for admissibility. This allows lay witnesses to present false opinions as verified scientific fact, or as the basis for a law-expert opinion.
7. **Dissemination of Misinformation:** As described above, AI can monitor and find useful social media evidence. However, it can also wield the power of social media to maliciously generate false information and evidence. AI can be unleashed to wage a social media disinformation campaign. It can flood various platforms in a reputation manipulation campaign targeting the judge, opposing counsel, parties, or witnesses. It can untraceably tamper with or poison a jury pool, spreading lies or false legal positions and authority. It can significantly damage the reputation of court participants, enabling the other side to provide negative reputation testimony to undermine the credibility of opposing witnesses. And these efforts could create sufficient taint to legitimately support a motion to recuse or venue transfer motion under TRCP 257.
8. **Facilitated Hacking:** Hackers use AI systems to breach secure cloud databases and obtain unauthorized access to sensitive personal information. Clients' financial, medical, or personal communications, including attorney-client privileged emails, could be surreptitiously obtained. Moreover, hackers can target law firms seeking to break into their secure servers, obtaining access to all privileged records and client files. Lawyers should question the source of such information to avoid running afoul of criminal prohibitions on the use of stolen digital data, such as the Texas Penal Code 16.04. Additionally, these systems can hack dating apps and target unwary spouses for romantic entrapment using AI chatbot baiting.

9. **Voluminous Records:** One of the great benefits of AI is the handling of voluminous records: thousands of documents, millions of emails, or decades of bank statements and canceled checks. Through AI analysis, there is the possibility that all could be categorized and summarized, potentially one day without human oversight. However, important questions remain about the validation of such tools and the ongoing role of human oversight. The committee will explore how to address risks presented by greater use of this technology.
10. **Local Rules and Court Practices:** AI systems can analyze a court participant's public life and social media presence, seeking leverage for inappropriate strong-arming and manipulation. In a similar way, the systems can be unleashed on a judge's personal and professional history, determining personal predilections, biases, and likely outcomes. The old saying, "A good lawyer knows the law. A great lawyer knows the judge," takes on new meaning when the knowledge includes a detailed and thorough psychological and historical evaluation of the judge.

A review of Texas Rule of Evidence 901 provides:

Rule 901. Authenticating or Identifying Evidence

(a) In General. To satisfy the requirement of authenticating or identifying an item of evidence, the proponent must produce evidence sufficient to support a finding that the item is what the proponent claims it is.

(b) Examples. The following are examples only--not a complete list--of evidence that satisfies the requirement:

(1) ***Testimony of a Witness with Knowledge.*** Testimony that an item is what it is claimed to be.

(2) ***Nonexpert Opinion About Handwriting.*** A nonexpert's opinion that handwriting is genuine, based on a familiarity with it that was not acquired for the current litigation.

(3) ***Comparison by an Expert Witness or the Trier of Fact.*** A comparison by an expert witness or the trier of fact with a specimen that the court has found is genuine.

(4) ***Distinctive Characteristics and the Like.*** The appearance, contents, substance, internal patterns, or other distinctive characteristics of the item, taken together with all the circumstances.

(5) ***Opinion About a Voice.*** An opinion identifying a person's voice--whether heard firsthand or through mechanical or electronic transmission or recording--based on hearing the voice at any time under circumstances that connect it with the alleged speaker.

(6) ***Evidence About a Telephone Conversation.*** For a telephone conversation, evidence that a call was made to the number assigned at the time to:

(A) a particular person, if circumstances, including self-identification, show that the person answering was the one called; or

(B) a particular business, if the call was made to a business and the call related to business reasonably transacted over the telephone.

(7) ***Evidence About Public Records*****.** Evidence that:

(A) a document was recorded or filed in a public office as authorized by law; or

(B) a purported public record or statement is from the office where items of this kind are kept.

(8) ***Evidence About Ancient Documents or Data Compilations*****.** For a document or data compilation, evidence that it:

(A) is in a condition that creates no suspicion about its authenticity;

(B) was in a place where, if authentic, it would likely be; and

(C) is at least 20 years old when offered.

(9) ***Evidence About a Process or System*****.** Evidence describing a process or system and showing that it produces an accurate result.

(10) ***Methods Provided by a Statute or Rule*****.** Any method of authentication or identification allowed by a statute or other rule prescribed under statutory authority.

Let's start with the basics of evidence. We can look to the Federal Rules as most states have adopted them. The Federal Rules of Evidence stipulate that, for an item to be accepted as evidence, it must meet criteria of relevance and authenticity. Relevance necessitates that the evidence offered possesses ample probative value to warrant its inclusion. See Fed. R. Evid. 401. In terms of the admissibility of relevant evidence, Rule 402 specifies that "Relevant evidence is admissible unless any of the following provides otherwise: the United States Constitution; a federal statute; these rules; or other rules prescribed by the Supreme Court. Irrelevant evidence is not admissible." See Fed. R. Evid. 402. To authenticate or identify evidence, the proponent is obligated to present sufficient evidence supporting a determination that the item is indeed what the proponent asserts it to be. See Fed. R. Evid. 901.

The advent of diverse communication technologies has transformed the dynamics of interpersonal communication. See Jeffrey Bellin, Facebook, Twitter, and the Uncertain Future of Present Sense Impression, 160 U. PA. L. Rev. 331, 332-34 (2012) (acknowledging the substantial influence of new technological developments on the modes and tools used in human communication).

The evolution of communication methods driven by technological advancements has significantly influenced the regulations concerning hearsay. See id. at 332-33 (indicating the need for potential adjustments to rules that traditionally exclude certain types of statements from hearsay).

The court in Lorraine v. Markel American Insurance Company outlined the five questions courts use to determine whether electronically stored information (ESI) may be admitted into evidence. The court stated that "[w]henever ESI is offered as evidence, either at trial or in summary judgment, the following evidence rules must be considered":

1. Is the ESI relevant as determined by Rule 401 (does it have any tendency to make some fact that is of consequence to the litigation more or less probable than it otherwise would be)?
2. If relevant under Rule 401, is it authentic as required by Rule 901(a) (can the proponent show that the ESI is what it purports to be)?
3. If the ESI is offered for its substantive truth, is it hearsay as defined by Rule 801, and if so, is it covered by an applicable exception (Rules 803, 804, and 807)?
4. Is the form of the ESI that is being offered as evidence an original or duplicate under the original writing rule, or if not, is there admissible secondary evidence to prove the content of the ESI (Rules 1001–1008)?
5. Is the probative value of the ESI substantially outweighed by the danger of unfair prejudice or one of the other factors identified by Rule 403, such that it should be excluded despite its relevance?

Lorraine v. Markel American Ins. Co., 241 F.R.D. 534, 538 (D. Md., 2007).

Electronic Evidence Under Existing Rules

While electronic evidence and online communications may seem like new and unique areas in evidence, they are evaluated under the same familiar rules judges have always used. State and federal courts have rejected calls to abandon the existing rules of evidence when evaluating electronic evidence.

For example, a Pennsylvania court addressed the authentication required to introduce transcripts of instant message conversations:

"Essentially, appellant would have us create a whole new body of law just to deal with e-mails or instant messages. The argument is that e-mails or text messages are inherently unreliable because of their relative anonymity and the fact that, while an electronic message can be traced to a particular computer, it can rarely be connected to a specific author with any certainty. Unless the purported author is actually witnessed sending the e-mail, there is always the possibility it is not from whom it claims. As appellant correctly points out, anybody with the right password can gain access to another's e-mail account and send a message ostensibly from that person. However, the same uncertainties exist with traditional written documents. A signature can be forged; a letter can be typed on another's typewriter; distinct letterhead stationery can be copied or stolen. We believe that e-mail messages and similar forms of electronic communication can be properly authenticated within the existing framework of [the rules of evidence and case law].... We see no justification for constructing unique rules of admissibility of electronic communications such as instant messages; they are to be evaluated on a case-by-case basis as any other document to determine whether or not there has been an adequate foundational showing of their relevance and authenticity."

In re F.P., 878 A.2d 91, 95-96 (Pa. Super. Ct. 2005).

The requirement of authentication or identification is a crucial condition for the admissibility of evidence, satisfied by sufficient evidence to support that the matter is what its proponent claims. According to Tex. R. Evid. 901(a), if the evidence is not what the proponent claims, it cannot be relevant. A party must make a prima facie showing for an exhibit's admission, and unless self-authenticating under Rule 902, extrinsic evidence is required. Tex. R. Evid. 901(b) provides illustrations for compliance.

Rule 901 sets a preliminary standard to test evidence reliability, subject to cross-examination. The foundation required varies with circumstances and judges' discretion. There's no uniform approach for authenticating electronic evidence due to rapid technological changes. The same rules of evidence apply to both electronic and traditional evidence, and both can be unreliable. As stated in In re F.P., 878 A.2d 91, 95 (Pa. 2005), the same concerns about reliability apply to all types of evidence.

Digital Converted Images

To authenticate digitally converted images, testimony is needed about the conversion process from film to digital format, requiring a witness with personal knowledge of its accuracy and reliability under Rules 901(b)(1) and 901(b)(9), which may involve expert testimony under Rule 702. Alternatively, a witness familiar with the scene depicted in the photo can testify to its accuracy, bypassing the need for conversion process testimony. For digitally enhanced images, which might alter the original scene (e.g., removing shadows or intensifying colors), proof under Rule 901(b)(9) is required to show the enhancement process is reliable and accurate, typically involving expert testimony under Rule 702.

COMMENTS:

While we acknowledge that there is an evidentiary concern from “deepfakes” and that the technology is improving rapidly, Rule 901 sets a preliminary standard to test evidence reliability, subject to cross-examination. The foundation required varies with circumstances and judges' discretion. There is no uniform approach for authenticating electronic evidence due to rapid technological changes. The same rules of evidence apply to both electronic and traditional evidence, and both can be unreliable. Moreover, judges can still consider holding a pretrial hearing to evaluate the parties' arguments and any expert testimony.

ADDITIONAL COMMENTS:

While some of these comments may not directly pertain to a rule change, this Committee also reviewed and agrees that the following additional recommendations made by the TRAIL Task Force would improve the functioning of the courts in terms of AI:

1. Increase Texas lawyers' awareness of the benefits and risks of AI by expanding the number of CLEs and articles regarding the same.
2. Consider requiring 1 hour of MCLE per year to meet the technical competency and proficiency requirements of Texas Disciplinary Rules of Professional Conduct, Rule 1.01, Comment 8.
3. Examine and review TRCP 13, Effect of Signing Pleadings, Motions, and Other Papers: Sanctions, to ensure that trial and appellate courts have adequate remedies regarding AI-generated misinformation or hallucinations.
4. Review Ethics Opinion ABA Formal Opinion 512 issued on July 29, 2024.
5. Consider and revise these recommendations once the Texas Ethics Opinion is issued regarding the use of AI. This committee understands that we are awaiting the issuance of a Texas Ethics opinion on the use of AI in practice.
6. Increase and support AI integration and education for low-income and pro bono legal service providers.

Tab E

Memo

To: Texas Supreme Court Advisory Committee

From: Subcommittee on Rules 216-299a

Date: October 17, 2024

Subject: Proposed Rule 226a amendment to reflect current technology and Generative AI

Texas Rule of Civil Procedure 226a sets out the instructions to be given to potential jurors when assigned to a jury venire as well as additional instructions given to jurors when they are seated on a jury. The Instructions include references to defunct technology and do not address Generative AI. Rules 216-299a Subcommittee proposes the following amendments to Rule 226a to reflect current technology as well as reference Generative AI.

Paragraph 3 of the Venire instructions and Paragraph 4 of the instructions to empaneled jurors are the same and could be updated as follows:

Redlined:
Do not discuss this case with anyone, even your spouse or a friend, either in person or by any other means [including ~~by~~ but not limited to phone, text message, email ~~message~~, ~~chat room,~~ blog, or social networking electronic platforms and websites ~~such as~~, including Facebook, X (Twitter), or ~~Myspace~~Instagram]. Do not allow anyone to discuss the case with you or in your hearing. If anyone tries to discuss the case with you or in your hearing, tell me immediately. We do not want you to be influenced by something other than the evidence admitted in open court.

Clean:

Do not discuss this case with anyone, even your spouse or a friend, either in person or by any other means [including but not limited to phone, text message, email, blog, or social networking electronic platforms and websites, including Facebook, X (Twitter), or Instagram]. Do not allow anyone to discuss the case with you or in your hearing. If anyone tries to discuss the case with you or in your hearing, tell me immediately. We do not want you to be influenced by something other than the evidence admitted in open court.

Do not discuss this case with anyone, even your spouse or a friend, either in person or by any other means [including but not limited to phone, text message, email, blog, or social networking electronic platforms and websites, including Facebook, X (Twitter), or Instagram]. Do not allow anyone to discuss the case with you or in your hearing. If anyone tries to discuss the case with you or in your hearing, tell me immediately. We do not want you to be influenced by something other than the evidence admitted in open court.

Paragraph 1 of the instructions for seated jurors should also be revised as follows:

Redlined:

1. Turn off all phones and other electronic devices. While you are in the courtroom and while you are deliberating, do not communicate with anyone through any electronic device. [For example, do not communicate by phone, text message, email~~ message~~, ~~chat room~~message, blog, or social networking electronic platforms and websites~~ such as ~~, including Facebook, X (Twitter), or ~~Myspace~~Instagram.] [I will give you a number where others may contact you in case of an emergency.] Do not post information about the case on the Internet before these court proceedings end and you are released from jury duty. Do not record or photograph any part of these court proceedings, because it is prohibited by law.

Clean:

1. Turn off all phones and other electronic devices. While you are in the courtroom and while you are deliberating, do not communicate with anyone through any electronic device. [For example, do not communicate by phone, text message, email, message, blog, or social networking electronic platforms and websites, including Facebook, X (Twitter), or Instagram.] [I will give you a number where others may contact you in case of an emergency.] Do not post information about the case on the Internet before these court proceedings end and you are released from jury duty. Do not record or photograph any part of these court proceedings, because it is prohibited by law.

Additionally, Paragraph 6 of the instructions for seated jurors should be revised:

Redlined:

6. Do not investigate this case on your own. For example, do not:

  a. try to get information about the case, lawyers, witnesses, or issues from outside this courtroom;
  b. go to places mentioned in the case to inspect the places;
  c. inspect items mentioned in this case unless they are presented as evidence in court;
  d. look anything up in a law book, dictionary, or public record to try to learn more about the case;
  e. look anything up on the Internet or by using artificial intelligence tools to try to learn more about the case; or
  f. let anyone else do any of these things for you.

This rule is very important because we want a trial based only on evidence admitted in open court. Your conclusions about this case must be based only on what you see and hear in this courtroom because the law does not permit you to base your conclusions on information that has not been presented to you in open court. All the information must be presented in open court so the parties and their lawyers can test it and object to it. Information from other sources, like the Internet or artificial intelligence tools, will not go through this important process in the courtroom. In addition, information from other sources could be completely unreliable. As a result, if you investigate this case on your own, you could compromise the fairness to all parties in this case and jeopardize the results of this trial.

Clean:

6. Do not investigate this case on your own. For example, do not:
   - a. try to get information about the case, lawyers, witnesses, or issues from outside this courtroom;
   - b. go to places mentioned in the case to inspect the places;
   - c. inspect items mentioned in this case unless they are presented as evidence in court;
   - d. look anything up in a law book, dictionary, or public record to try to learn more about the case;
   - e. look anything up on the Internet or by using artificial intelligence tools to try to learn more about the case; or
   - f. let anyone else do any of these things for you.

This rule is very important because we want a trial based only on evidence admitted in open court. Your conclusions about this case must be based only on what you see and hear in this courtroom because the law does not permit you to base your conclusions on information that has not been presented to you in open court. All the information must be presented in open court so the parties and their lawyers can test it and object to it. Information from other sources, like the Internet or artificial intelligence tools, will not go through this important process in the courtroom. In addition, information from other sources could be completely unreliable. As a result, if you investigate this case on your own, you could compromise the fairness to all parties in this case and jeopardize the results of this trial.

Tab F

FORDHAM

University School of Law

Lincoln Center, 150 West 62nd Street, New York, NY 10023-7485

Daniel J. Capra
Philip Reed Professor of Law
Phone: 212-636-6855
e-mail:dcapra@law.fordham.edu

Memorandum To: Advisory Committee on Evidence Rules
From: Daniel J. Capra, Reporter
Re: Artificial Intelligence, Machine-Learning, and Possible Amendments to the Federal Rules of Evidence
Date: October 1, 2024

Beginning in Fall 2023, the Committee has been considering the challenges posed by the development of Artificial Intelligence and its possible impact on evidence offered at a trial. The Committee has convened two separate panel discussions to obtain information from experts in the field. The Committee has focused on two separate concerns: 1) the problem of "deepfakes" and how to assure that the Evidence Rules on authenticity will work to prevent hard-to-detect fake video and audio evidence from being admitted at trial and 2) The problem of machine learning and how to assure that machine learning output is reliable, if such evidence is admitted without the testimony of an expert.

While recognizing the legitimate concerns posed by AI and machine-learning, Committee members have expressed the concern that, given the length of the rulemaking process, there is a risk that any proposed amendments to deal with AI could become outmoded before they even go into effect --- and that any amendment written in terms so general as to avoid being outmoded might add little to the already general and flexible language in the Federal Rules of Evidence. On the other hand, the unprecedented interest in the Committee's work on AI, even at this preliminary stage, counsels against inaction unless it is clear that a rule will not be helpful.

This memorandum is in four parts. Part One discusses some of the recent cases and developments since the last meeting, including the public focus on the Committee's work. Part

Two presents a discussion of possible amendments suggested by various experts and scholars.[1] Part Three provides background information on the problem of deepfakes, the rules on authenticity, and prior Committee review of authentication of social media evidence.[2] Part Four sets forth two specific proposals for addressing AI and machine learning --- really a mix and match of the best parts of the proposals considered in Part Two.

It should be noted that there is no action item, for this meeting, on any of the matters discussed in this memo.

I. New Information

Here is a list of new information and data points that have come to my attention since the last meeting.

A. Articles and Reports

● **Law Review Article:** Myhand, *Once the Jury Sees it, the Jury Can't Unsee it: The Challenge Trial Judges Face When Authenticating Video Evidence in the Age of Deepfakes,* 29 Widener L. Rev. 171 (2024):

The author, like many others, sounds an alarm about deepfakes and considers the problem to be qualitatively different from that imposed by forgeries in the past. In his view, no amendment to the Evidence Rules will solve the problem, because neither judges nor juries are in any position to assess whether an item is a deepfake.

He recommends that all proponents of video evidence be required to submit with their proffered evidence an Affidavit of Forensic Analysis (AFA) from a qualified expert. An AFA would be used to assist the trial judge in performing the gatekeeping function under Rule 104(b). He describes the procedure as follows:

> Before the trial or hearing, a party offering video evidence must submit an affidavit from an expert whose testimony regarding forensic video analysis would be admissible at the trial or hearing under Federal Rule of Evidence 702. The expert's affidavit must state an opinion regarding the authenticity of the proffered video evidence, the method used to analyze the video, and the chain of custody of the video as reported by the proffering party.

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[1] Some of this section was included in the AI memo for the Spring meeting, but there are revised proposals, and the Committee has never gone through these proposals one by one.

[2] But for a few changes, this section was included in the AI memo for the Spring meeting.

The AFA would be provided only as a tool to assist the trial judge in deciding whether there is sufficient evidence to support a reasonable jury's finding that the video evidence is what the proponent purports it to be. The AFA would not be admissible at trial.

The proposal is modeled after the Affidavit of Merit statutes that some states have required in professional malpractice claims, purportedly to screen out fraudulent claims.

> **Reporter's Comment:** The biggest problem with this proposal is expense and delay. Proponents will need an expert affidavit for *every piece of video evidence*. And that affidavit must itself comport with Rule 702, which means a potential *Daubert* hearing for every affidavit. The rule probably needs to be further extended to *audio* evidence as well, thus adding to the delay and expense imposed by the proposal.
>
> The other problem is that this affidavit is not presented to the jury --- so the jury remains ill-equipped to root out a possible deepfake.
>
> If this proposal is thought promising, it would have to be implemented through a change to Rule 901 (or maybe a new freestanding rule 901(c) or (d). Congress likely won't impose such a rule, and the courts are unlikely to do so en masse. So if the Committee is interested in this proposal, it can be considered as a possible amendment to Article 9 at the next meeting.

- **Article: Daniel Seng, *Artificial Intelligence and Evidence,* 33 Singapore Law Journal 241 (2024):**

The author describes a good process for regulating allegations of deepfakery:

> [The opponent] should be required to provide advance warning to the trial judge that the authenticity of identified aspects of the evidence will be questioned, and to set out the grounds upon which the challenge is made. If this first hurdle is overcome, it will be for the trial judge to decide whether a trial within a trial is necessary, and if so, to set out the scope and perameters of the hearing, including the standard of proof, for which a ruling is required.

The author also discusses potential advancements in the means to detect deepfakes:

> While software tools are readily available to allow an end user to test various hypotheses in the analysis of image manipulation, it remains, for the time being, the domain of the expert to interpret the test results and form a conclusion. One day, technologies might

> be available to perform a set of tests, which can be weighted, and used to draw informed conclusions about the image being manipulated.

He finally concludes that the evidentiary principles needed to cover deepfakes are already in place:

> [T]he evidential treatment of the issue of manipulated digital data is no different from any other electronic evidence that needs authentication. * * * [I]ssues with digital data that is manipulated requires the court to develop a set of clear procedures for managing authentication issues, a healthy appreciation of the limits of the presumption of reliability, and a robust approach towards disclosure of discovery.

Finally, the author analyzes and summarizes the controversy over disclosure of source codes to the opponent, when the proprietor of the software invokes trade secret protection. He notes the "brouhaha" involving breathalyzers, where defense lawyers sought inspection of their codes and were rebuffed, until discovery was granted in a particular case and it was determined that there were calibration and calculation errors in the coding of the machines that resulted in results that were 20% to 40% too high. He also notes coding errors discovered by adversaries in cases involving Toyotas that cause sudden acceleration, and in the environmental sensors in Uber self-drive cars. The author concludes that it is important to provide disclosure of source codes, and that access by the adversary can be controlled by in camera proceedings and protective orders. He notes that Professor Imwinkelried has suggested that an alternative to disclosure of source codes is for the opponent to be given access to the validation studies that support the AI process. He states, however, that validation studies are unlikely to be useful "for complex systems such as those used in AI systems, and their use may raise additional questions such as the number of validation tests required, the assumptions made as to the number of such tests, the procedures used to conduct the tests and how these can be conducted within a practical period of time."

> **Reporter's Comment:** The source codes controversy is a hot button topic. It is arguably better placed in the civil and criminal discovery rules. Although there are of course notice requirements in the Evidence Rules, none of them require the disclosure of anything like source codes and metadata. One would probably look in the civil and criminal rules for regulations on disclosure of information like a source code. That is especially true because the provision would probably have to provide for a balancing process and procedural regulations, all of which seems to go beyond admissibility of evidence.
>
> If anything is to be done about source codes in the Evidence Rules, it should probably be by way of a suggestion in a Committee Note, as was done in the Committee Note to the 2000 amendment to Rule 701 (providing that the Rule needed to be amended to assure that the expert disclosure requirements in the Civil and Criminal Rules would not be evaded).

• **Short Article: Laura Lorek, *Artificial Intelligence: Real Problem* » ABA Journal, September 2024:** Besides going over the now well-trod scares about AI wreaking havoc with the legal system, the article does add two points:

> 1) It quotes the Vice President of a global intelligence program as predicting "a new class of video verification experts" that will be part of virtually every case; and
>
> 2) Contrarily, it reports that "Google is creating watermarks to identify deepfake videos and has placed information in the metadata of photos and documents that reveal AI created them."
>
> **Reporter's Comment:** As to the second point, it is at least possible that sometime in the future, watermarking and related security efforts will make it very difficult or impossible to sneak in a deepfake. And if that is so, it would not be ideal if a rule addressed to deepfakes comes into effect just as, or after, the problem has been substantially diminished.

• **Article: Law360.com, *Deepfake Proposals Navigate Perfect Evidentiary Storm***

This is an article about the Advisory Committee's Work on Deepfakes. Here are some excerpts:

> As federal judiciary officials explore how to handle evidence faked by artificial intelligence, attorneys are divided over the need to change evidence rules, with some worried that current rules are not up to the challenges posed by deepfakes, and others fearful that altering them might do more harm than good. The current rules don't contemplate the ease with which AI can now fake photographs, audio and video, and are more intended to decide admissibility rather than authenticity, say some attorneys, who warn of the "evidentiary storm" this issue has created.
>
> But the rules, which have long been able to handle false evidence, are perfectly capable of handling AI-generated photos and recordings as well, other experts say. Changing those rules could harm courtroom efficiency and access to justice, and the better approach may be to give judges more education and resources so they can apply the existing rules to deepfakes, those experts contend.
>
> The Judicial Conference's Advisory Committee on Evidence Rules is now wading into the issue, having met in April to hear from both sets of academics and consider potential rule changes to handle the possibility of AI-generated evidence being introduced in court. The panel is expected to issue a report on those proposals, but is unlikely to come to any decisions and probably won't for several years, experts told Law360. Some

of those scholars say that caution is for the best, while others worry that delay will create serious problems, given that disputes over allegedly fake evidence are already finding their way into court. * * *

The Coming “Evidentiary Storm”

Generative AI’s ability to create realistic-seeming photographs, audio and video, often referred to as “deepfakes,” makes it urgent to change the federal rules of evidence now, say some experts. That’s because the current rule governing evidence authentication, Rule 901(a), dictates that the party seeking to introduce that evidence must only show enough proof “to support a finding that the item is what the proponent claims it is,” a standard the committee itself called low. Litigants hoping to introduce a voicemail or photograph into court only have to offer proof that the voice on the recording or the person in the image is the person it’s said to be, according to experts.

“And that was not particularly difficult or challenging for the courts or for juries to understand,” said Loyola Law School, Los Angeles professor Rebecca Delfino, who has recommended a rule change being considered by the evidence rules committee. “But the whole concept of AI generative technology and deepfakes has sort of upended this because the prior modes of having evidence authenticated and presented really don’t work as easily as they used to,” Delfino told Law360. Those methods were designed for traditional evidentiary disputes, when parties agree on the nature of the evidence — that something is a voicemail or a photograph — and are only at odds over its admissibility.

“We disagree on whether the evidence should come in, but we’re not disagreeing about what it is,” said Former Federal Judge Paul Grimm, who posed several rule changes currently before the committee. But once alleged deepfakes come into court, “now you’ve got a dispute about the very nature of what the evidence is.”

The fact that deepfakes can now be created so easily, cheaply and convincingly, and that the technology has improved to the point that even computer experts have difficulty discriminating between real and fake, creates a “perfect evidentiary storm,” according to Grimm. That storm is already coming ashore, according to Delfino, who points out that Tesla lawyers recently claimed in court that videos of CEO Elon Musk making statements about the safety of the company’s self-driving cars could be deepfakes in an attempt to shield Musk from being deposed in a wrongful death suit. “That’s not an argument he could have made five years ago,” Delfino said. * * * “The number of cases where the underlying claim will be deepfakes — something about a deepfake — that’s coming,” Delfino said. “There’s going to be new tort claims that didn’t previously exist, new crimes that didn’t previously exist.”

So federal courts should change the rules of evidence now, both Grimm and Delfino insist. “For this particular type of evidence, which has the unique ability to so dramatically affect the outcome of a case, the evidence rules just simply don’t seem to work,” Grimm said.

Proposed Changes

Grimm, along with professor Maura Grossman, who teaches at the University of Waterloo and Osgoode Hall Law School in Canada, have proposed a new rule — Rule 901(c) — which would govern “potentially fabricated or altered electronic evidence,” according to the committee. * * * “The existing rules of evidence, which are technology-agnostic, make it too easy to get this kind of high-technology evidence introduced to a jury, because it only has to be more likely than not that it is what it purports to be,” Grimm said.

Delfino instead suggests changing Rule 901 to mandate that evidence’s authenticity be decided by judges rather than juries. Under the current evidentiary rules, a judge makes an initial assessment about whether or not a reasonable jury could find that a piece of evidence is authentic. Once the court determines that a jury can find something authentic, the ultimate decision about whether it actually is real goes to the jury, Delfino explained. But juries aren’t equipped to make that determination, she said. A study done by the Max Planck Institute in 2021, for instance, found that even after people are taught to detect deepfakes, they still aren’t able to. The study found that people generally lean toward thinking deepfakes are authentic and overestimate their ability to detect faked images, Delfino said.

“People are really susceptible to being influenced by deepfake content and can’t really figure out what is real and what is not,” Delfino said. But judges spend years dealing with evidence and questions of admissibility and authenticity, so they are “slightly better” able to make those decisions, according to her. “This is what they do. This is their job. This is why they’ve been appointed to the bench, is that they’re really good at sort of holding at bay any of those biases that everybody else applies,” Delfino said.

Not everyone agrees with those changes, or with changing the rules of evidence at all. It places too much of a burden on judges to expect them to decide questions of authenticity, as Delfino’s proposed rule would, according to Bruce Hedin, president of Hedin B Consulting and a legal technology expert. What courts could be doing is providing judges with more resources and education about AI, said Hedin, who envisions a "resource hub" or "help desk model" for judges making evidentiary decisions. Judges could also turn to special masters or consultants in some cases, according to Hedin. "If they were given greater access to resources and encouraged to draw on experts when they were confronted with these technical questions, then they would be in a position to make better decisions," Hedin said. He isn't opposed to changing the rules of evidence, but says any modifications are likely to take far longer than educating judges would. * * *

Changes in the rules aren't even necessary, according to Riana Pfefferkorn of the Stanford Internet Observatory, who is a former associate in the internet strategy and litigation group at Wilson Sonsini. The existing rules of evidence are perfectly capable of handling deepfakes, she said. "The courts have had hundreds of years to develop their immune system against fake evidence, since well before the codification of the federal evidence rules, and it's endured through successive generations of new technologies," Pfefferkorn said. Attorney ethics rules, which forbid the introduction of evidence a lawyer suspects is false, offer "another speed bump" to deepfakes in court, Pfefferkorn added. "Lawyers have their own skin in the game when it comes to keeping deepfakes out of evidence," she said. Raising the authentication bar could actually do more harm than good by slowing the courts, creating more work for litigants and judges, and putting litigants with fewer resources at a disadvantage, affecting access to justice, according to Pfefferkorn. "The trend has been to streamline authentication, not to throw up more roadblocks," Pfefferkorn said. "Absent a compelling showing of an epidemic of litigants trying to sneak deepfakes into evidence, I don't see a need to reverse that trend."

At Least a Few Years Away

Experts may disagree about whether changes to the rules of evidence are necessary, but they agree that any potential shifts aren't likely soon. "If everybody in the room raised their hand and agreed, 'Let's change the rule,' we're talking three to five years," Grimm said. He pointed out that changes made to the rule governing expert evidence that went into effect in December 2023 were 20 years in the making. * * * Members of the committee evaluating the proposals are likely concerned that any change they make will quickly become obsolete as the technology evolves, Delfino said.

The judiciary is more likely to take a wait-and-see approach, allowing courts to use the existing rules to make decisions that will then be appealed. From those appeals will come a body of common law the judiciary can look to in deciding if new rules are necessary, according to Delfino. "I think this is what the committee thinks," Delfino said. "The common law will develop, it will point the way where the need actually is, and then maybe the rule change will follow."

> That caution in the face of evolving technology is warranted, according to Hedin, who said, “We want these rules to be robust and durable and long-lasting.” But Delfino worries that delay could create a patchwork of different interpretations of the rules of evidence in different courts. “My personal opinion is we should be changing these rules now,” said Delfino, who indicated that she’s encountered skepticism about the urgent need for rule changes from judiciary officials, who don’t seem to agree with her.
>
> The committee hasn’t said no to any of the proposed rule changes, according to Grimm. “They just said, ‘We’re not ready to do it now,’” so changes could still be coming, he said.
>
> But federal courts will have to take action in the near future, whether that action involves rule changes or other approaches, according to Hedin.

● **New York State Bar Association Task Force on AI, April 2024** (excerpt on use of AI-generated evidence, discussing, among other things, the Advisory Committee’s work):

> Judges face challenges in evaluating the admissibility of AI-generated or compiled evidence. Concerns include the reliability, transparency, interpretability and bias in such evidence. These challenges become even more pronounced with the use of generative AI systems. A discussion follows regarding two recent proposals to address these challenges.
>
> *Federal Law --- a Proposal to Amend Rule 901(b)(9)*
>
> * * *
>
> The Advisory Committee for the Federal Rules of Evidence is considering a proposal by former U.S. District Judge Paul Grimm and Dr. Maura R. Grossman of the University of Waterloo to amend Fed. R. Evid. 901(b)(9). That proposal initially changes the “accurate” standard as it currently exists for any evidence about a process or system and replaces it with a requirement that the proponent provide evidence that the process or system produces a “reliable” result. For evidence generated by AI, the proponent must also (a) describe the software or program that was used and (b) show that it has produced reliable results in the proposed evidence.
>
> *New York: Proposed Amendments to the Criminal Procedure Law and CPLR*
>
> New York State Assemblyman Clyde Vanel has introduced a bill, A 8110, which amends both the Criminal Procedure Law and the CPLR, regarding the admissibility of evidence created or processed by artificial intelligence. As stated in the bill, evidence is

> “created” by AI when AI produces new information from existing information. Evidence is “processed” by AI when AI produces a conclusion based on existing information.
>
> Simplified greatly, the bill requires that evidence “created” by AI would not be received at trial unless independent admissible evidence establishes the reliability and accuracy of the AI used to create the evidence. Evidence “processed” by AI similarly requires the proponent of the evidence to establish the reliability and accuracy of the AI used. The bill does not yet have a cosponsor in the Assembly and does not have a sponsor in the Senate.
>
> The goals of both the proposal to amend Fed. R. Evid. 901 and the Vanel bill are laudable. The “black box” problem of AI is of great concern to lawyers and judges and has significant due process concerns in the criminal justice area. These proposals thus attempt to address AI-generated “deepfakes” that could be passed off as authentic evidence. *Nevertheless, given the intricacies and time involved in the legislative and rule-amending processes, it may well be that the common law at the trial court level provides at least an interim roadmap for how judges should consider these issues. Indeed, this approach was largely employed to develop the law regarding discovery and admissibility of social media evidence when those issues first took hold.* (emphasis added)

Reporter’s Comment: The New York proposed legislation is complicated and detailed, much more so than what one would find in the Federal Rules of Evidence. One aspect of complication is that the statute distinguishes between evidence “created” by AI and evidence “processed” by AI, even though the standards of admissibility are basically the same for both types of evidence.

- **Short Article: Sherman & Howard**, ***Addressing Challenges of Deepfakes and AI - Generated Evidence,*** JDSupra.com, September 18, 2-24

This article describes and evaluates the Grimm-Grossman proposal to amend Rule 901 to regulate deepfakes. That proposal is set forth, as modified, later in this memo.

> The driving force behind these proposed changes is the fear that the existing rules may be inadequate for handling the unique issues posed by AI and machine learning. Unlike traditional manufactured evidence, deepfakes are harder to detect, making it easier to pass off fabricated content as real. Furthermore, the low threshold for authenticity under FRE 901(a) only requires “evidence sufficient to support a finding.” This standard might allow deepfakes to be admitted without scrutiny.
>
> The [Advisory] committee recognized that as AI technologies evolve, they will be used to create evidence for both legitimate and illegitimate purposes. Therefore, it is

essential to update the rules to ensure that AI-generated evidence meets higher standards of reliability and authenticity before being presented in court.

What's Next

The committee has not formally adopted these proposed changes, and discussions are ongoing about whether they should be applied only to AI-generated evidence or more broadly to other forms of digital content. The proposal to modify Rule 901(b)(9) and introduce 901(c) represents a proactive approach to addressing the potential misuse of AI and deepfakes in the courtroom. It will be interesting to see how the legal industry evolves to address the rapid advancements in AI, particularly as courts and practitioners adapt to new challenges in evidence authentication.

- **Article: Ralph Losey, *The Problem of Deepfakes and AI-Generated Evidence: Is it Time to Revise the Federal Rules of Evidence?***

This is an article about the Grimm-Grossman proposal to amend Rule 901 to address deepfakes. It is a stinging, and hopefully misguided, critique of the Reporter's memo to the Committee on AI that was submitted at the last meeting. Excerpts follow:

> From the record it appears that Grimm and Grossman were not given an opportunity to respond to [the Committee's] criticisms. So once again the Committee followed Professor Capra's lead and all of the rule changes they proposed were rejected. Again, with respect, I think Dan Capra missed the point again. Authentic evidence can already be withheld as too prejudicial under current Federal Evidence Rule 403 (Excluding Relevant Evidence for Prejudice, Confusion, Waste of Time, or Other Reasons). But the process and interpretation of existing rules is what is too complex. That is a core reason for the Grimm and Grossman proposals.
>
> Moreover, in the world of deepfakes things are not as black and white as Capra's analysis assumes. Often authenticity of audio visuals is a gray area question, a continuum, and not a simple yes or no. It appears that the Committee's decisions would benefit from the input of additional technology advisors, independent ones, on the rapidly advancing field of AI image generation.
>
> The balancing procedure Grimm and Grossman suggested is appropriate. If it is a close question on authenticity, and the prejudice is small, then it makes sense to let it in. If authenticity is a close question, and the prejudice is great, say even outcome determinative, then exclude it. And of course if the proof of authenticity is strong, and the probative value strong, even outcome determinative, then the evidence should be allowed. The other side

of the coin, if that if the evidence is strong that the video is a fake, it should be excluded, even if that decision is outcome determinative.

* * *

Capra's Questionable Evaluation of the Danger of Deepfakes

Naturally the Committee went with what they were told was the cautious approach. But is doing nothing really a cautious approach? In times of crisis inaction is usually reckless, not cautious. Professor Capra's views are appropriate for normal times, where you can wait a few years to see how new developments play out. But these are not normal times. Far from it.

We are seeing an acceleration of fraud, or fake everything, and a collapse of truth and honesty. Society has already been disrupted by rapid technical and social changes, and growing distrust of the judicial system. Fraud, propaganda and nihilistic relativism are rampant. What is the ground truth? How many people believe in an objective truth outside of the material sciences? How many do not even accept science? Is it not dangerous under these conditions to wait longer to try to curb the adverse impact of deepfakes?

There is little indication in Professor Capra's reports that he appreciates the urgency of the times, nor the gravity of the problems created by deep fakes. The "Deepfake Defense" is more than a remote possibility. The lack of published opinions on deepfake evidence should not lull anyone into complacency. It is already being raised, especially in criminal cases.

Consider the article of Judge Herbert B. Dixon Jr., Senior Judge with the Superior Court of the District of Columbia. *The "Deepfake Defense": An Evidentiary Conundrum* (ABA, 6/11/24). Judge Dixon is well known for his expertise in technology. For instance, he is the technology columnist for The Judges' Journal magazine and senior judicial adviser to the Center for Legal and Court Technology

Judge Dixon reports this defense was widely used in D.C. courts by individuals charged with storming the Capitol on January 6, 2021. The Committee needs more advisors like Judge Dixon. He wants new rules and his article The "Deepfake Defense" discusses three proposals: Grimm and Grossman's, Delfino's and LaMonica's. [These proposals are all discussed in Part Two of this memo.] Here is Judge Dixon's conclusion in his article:

> As technology advances, deepfakes will improve and become more difficult to detect. Presently, the general population is not able to identify a deepfake created

> with current technology. AI technology has reached the stage where the technology needed to detect a deepfake must be more sophisticated than the technology that created the deepfake. So, in the absence of a uniform approach in the courtroom for the admission or exclusion of audio or video evidence where there are credible arguments on both sides that the evidence is fake or authentic, the default position, unfortunately, may be to let the jury decide.

Judge Herbert B. Dixon Jr., The "Deepfake Defense."

Professor Capra addressed the new issues raised by electronic evidence decades ago by taking a go-slow approach and waiting to see if trial judges could use existing rules. That worked for him in the past, but that was then, this is now.

Courts in the past were able to adapt and used the old rules well enough. That does not mean that their evidentiary decisions might have been facilitated, and still might be, by some revisions related to digital versus paper. But Capra assumes that since the courts adapted to digital evidence when it became common decades ago, that his "wait and see" approach will work once again. * * * Professor Capra will only say that the past decision to do nothing is "not necessarily dispositive" on AI. That implies it is pretty close to dispositive. The Professor and Committee do not seem t0 appreciate two things:

1) The enormous changes in society and the courts that have taken place since the world switched from paper to digital. That happened in the nineties and early turn of the century. In 2024 we are living in a very different world. 2) The problem of deepfake audio-visuals is new. It is not equivalent to the problems courts have long faced with forged documents, electronic or paper. The change from paper to digital is not comparable to the change from natural to artificial intelligence. AI plays a completely different role in the cases now coming before the courts than has ever been seen before.

Is it really prudent and cautious for the Evidence Rules Committee to take the same approach with AI deepfakes as they did many years ago with digital evidence? AI now plays a completely new role in the evidence of the cases that now come before them. The emotional and prejudicial impact of deepfake audio-visuals is an entirely new and different problem. Plus, the times and circumstances in society have dramatically changed. The assumptions made by Committee Reporter Capra of the equivalence of the technology changes is a fundamental error. With respect, the Committee should reconsider and reverse its decision.

The assumption that the wait and see approach will work again with AI and deepfakes is another serious mistake. It is based on wishful thinking not supported by the evidence that the cure for deepfakes is just around the corner, that new software will soon be able to detect them. It is also based on wishful thinking that trial judges will again be able to muddle through just fine. Judge Grimm who just recently retired as a very active District Court trial judge disagrees. Judge Dixon who is still serving as a reserve senior trial judge in Washington D.C. disagrees. So do many others. The current rules are a muddled mess that needs to be cleaned up now. With respect, the Committee should reconsider and reverse its decision.

* * *

What are the consequences of continued inaction? What if courts are unable to twist existing rules to screen out fake evidence as Professor Capra hopes? What will happen to our system of justice if use of fake media becomes a common litigation tactic? How will the Liar's Dividend pay out? What happens when susceptible, untrained juries are required to view deep fakes and then asked to do the impossible and disregard them? How can courts function effectively without reliable rules and methods to expose deepfakes? Should we make some rule changes right away to protect the system from collapse? Or should we wait until it all starts to fall apart?

If we cannot reliably determine what is fake and what is true in a court of law, what happens then? Are we not then wide open and without judicial recourse to criminal and enemy state manipulation? Can law enforcement and the courts help stop deepfake lies and propaganda? Can we even have free and fair elections? How can courts function effectively without reliable rules and methods to expose deepfakes? Should we make some rule changes right away to protect the system from collapse? Or should we wait until it all starts to fall apart?

I expect the Rules Committee will follow Capra's advice and do nothing. But 2024 is not over yet and so there is still hope.

What Comes Next?

The next Advisory Committee on Evidence Rules is scheduled for November 8, 2024 in New York, NY and will be open to the public both in-person and online. While observers are welcome, they may only observe, not participate. In addition, we have just learned that Paul Grimm and Maura Grossman have submitted a revised proposal to the Committee, which will be discussed first. This was presumably done at the request of Professor Daniel Capra after some sort of discussion, but that is just speculation.

[This revised proposal is set forth in Part Two of this memo, infra. Obviously, Mr. Losey author favors adoption of the proposal at the earliest possible opportunity.]

Conclusion

> The upcoming Evidence Committee meeting is scheduled for November 8th, three days after election day on November 5th. What will our circumstances be? What will the mood of the country be? What will the mood and words be of the two candidates? Will the outcome even be known in three days after the election? Will the country be calm? Or will shock, anger and fear prevail? Will it even be possible for the Committee to meet in New York City on November 8th? And if they do, and approve new rules, will it be too little too late?

Reporter’s comment: If only the Reporter had the power that the overheated author subscribes to him. But it is good to know that an immediate amendment to Rule 901 is sufficient to prevent the end of litigation as we know it.

Article: Grimm, Grossman, et. al., ***Deepfakes in Court: How Judges: How Judges Can Proactively Manage Alleged AI-Generated Material in National Security Cases, Northwestern Law & Econ Research Paper No. 24-18, Northwestern Public Law Research Paper No. 24-26, available at https://ssrn.com/abstract=4943841 or http://dx.doi.org/10.2139/***

The authors provide a step-by-step approach for judges to follow when they grapple with the prospect of alleged deepfakes. They recommend that judges go beyond a showing that the evidence is merely more likely than not what it purports to be. Instead, judges must balance, under Rule 403, the risks of negative consequences that could occur if the evidence turns out to be fake. They recommend that courts schedule a pretrial evidentiary hearing far in advance of trial, where both proponents and opponents can make arguments on the admissibility of the evidence in question. They recommend that a judge order a “science day” for experts to school the judge about AI and deepfakes. They conclude that the judge should only admit evidence, allowing the jury to decide its disputed authenticity, after considering under Rule 403 whether its probative value is substantially outweighed by danger of unfair prejudice to the party against whom the evidence will be used. They conclude: “Our suggested approach thus illustrates how judges can protect the integrity of jury deliberations in a manner that is consistent with the current Federal Rules of Evidence and relevant case law.”

An article in JDSupra summarizes the Grimm et. al. article with the following points:

> 1. “While technological solutions such as watermarking have been proposed, they need to be more reliable. AI experts warn that adversaries, including state actors, are creating deepfakes sophisticated enough to evade current detection

> methods. For cybersecurity professionals, this presents a direct challenge: ensuring the authenticity of digital content in legal proceedings becomes a more intricate, ongoing battle.”
>
> 2. “The paper emphasizes the role of expert witnesses in helping courts distinguish between real and AI-generated evidence. However, given the current limitations in AI detection technologies, human experts may still struggle to accurately authenticate evidence.”
>
> 3. “A concept known as the “Liar’s Dividend” presents another critical challenge for the judiciary and eDiscovery experts. As the public becomes more aware of the existence of deepfakes, there is a growing risk that individuals will claim genuine evidence is fake to avoid accountability. This phenomenon, where real evidence is dismissed as AI-generated manipulation, complicates efforts to authenticate digital materials in court.”
>
> 4. “To mitigate the risks posed by deepfakes, the authors suggest that legal professionals, alongside cybersecurity and eDiscovery specialists, must adopt a more collaborative and technologically informed approach. This risk mitigation includes * * * investing in AI forensics [and] ongoing training.
>
> 5. “Cybersecurity experts, legal scholars, and AI researchers must work together to refine best practices for authenticating evidence in a world where deepfakes are increasingly common.”
>
> 6. “The paper concludes that while AI technology presents new challenges for the legal system, it also offers an opportunity for the courts, supported by cybersecurity and eDiscovery professionals, to evolve. By implementing robust frameworks and staying vigilant, the judicial system can preserve the integrity of trials in the face of rapidly advancing technology.”

Reporter’s Comment: The obvious question is, if this can be handled under existing rules, how do amendments improve the situation?

• **Article:** ***Courts Remain Skeptical About Lawyers’ Use of ChatGPT in Litigation,*** Bloomberg News, September 20, 2024:

> Generative artificial intelligence is making a bad first impression in the courts. Manhattan federal judge Edgardo Ramos recently described ChatGPT as an “unreliable resource,” and he’s not alone in expressing such concern about AI. The recent decisions

addressing use of generative AI by lawyers in New York federal courts demonstrate a persistent skepticism of the technology among the judiciary.

US District Judge Kevin Castel sanctioned lawyers in Mata v. Avianca last year for "abandon[ing] their responsibilities when they submitted non-existent judicial opinions with fake quotes and citations created by the artificial intelligence tool ChatGPT." The case made national headlines.

Since that time, some Manhattan federal judges have shone a bright line against any use of ChatGPT, repeatedly underscoring its purported unreliability beyond the context of basic legal research and citations.

For example, in the aforementioned case of *Z.H. v. N.Y.C. Dep't of Educ.*, Judge Ramos admonished a law firm for submitting questions and answers posed to and generated by ChatGPT as evidence of reasonable attorney hourly rates in support of an application by the firm for attorneys' fees.

Ramos afforded no weight to the ChatGPT Q&A and noted that US Magistrate Judge Robyn Tarnofsky in *D.S. v. N.Y.C. Dep't of Educ.* Declined to credit a similar submission by the same lawyers "because ChatGPT has been shown to be an unreliable resource."

Tarnofsky, in turn, supported her conclusion by citing to a line of cases where ChatGPT generated fake legal authorities, among which was *Park v. Kim*, a recent medical malpractice dispute, where the US Court of Appeals for the Second Circuit described how certain technologies that "may produce factually or legally inaccurate content" shouldn't replace "the lawyer's most important asset—the exercise of independent legal judgment."

In JG. V. NYC. Dep't of Educ. Earlier this year, US District Judge Paul Engelmayer took exception to the lawyers' failure to identify the "inputs on which ChatGPT relied" or to address "whether ChatGPT anywhere considered" key legal precedents.

Courts aren't inclined to impose a bright-line rule prohibiting attorneys' use of generative AI. In *Sillam v. Labaton Sucharow*, US Magistrate Judge Ona Wang expressed skepticism about attorneys' use of generative AI tools for brief writing, but maintained that attorneys have a "gatekeeping role" to "ensure the accuracy of their filings." Wang was also critical of the quality of the writing produced by generative AI tools, noting they resulted in "repetitive language" that "only restates general principles of law without making argument."

Likewise, in *Mata,* Judge Castel rejected the application of a bright-line rule against generative AI tools, noting that "[t]echnological advances are commonplace and there is nothing inherently improper about using a reliable artificial intelligence tool for assistance."

● **Article:** ***Fake Cases, Real Consequences,*** **ABA Journal, October/November 2024, at 13:**

The article is about generative AI hallucinating cases, citations, etc. It notes that a study conducted at Stanford found that "hallucination rates are alarmingly high for a wide range of verifiable legal facts." Moreover, "these models often lack self-awareness about their errors and tend to reinforce incorrect beliefs, the study found. They exhibit contrafactual bias --- the tendency to assume that a premise in a query is true even if it is flatly wrong."

B. Case Law

● **New Case Rejecting AI-Enhanced Video** ***Washington v. Puloka*****,** No. 21-1-04851-2 (Super. Ct. Kings Co. Wash. 2024). The defendant wanted to present a video that was AI-enhanced. The source video had "motion blur" and the defense expert used a Topaz Labs AI program to increase its resolution, add sharpness and definition, and smooth out the edges of the video images. The trial judge excluded the enhanced video. The court found that the expert was not a forensic video technician and conceded that he was not sure whether the Topaz Labs AI program was used in the forensic video analysis community. The expert could not point to any testing, publications or discussions within the group of users he identified that evaluated the reliability of Topaz. The expert testified that Topaz's AI used machine learning to enhance videos based on images in its training library, but "did not know what videos the AI-enhancement models are 'trained' on, did not know whether such models employ 'generative AI' in their algorithms, and agreed that such algorithms are opaque and proprietary."

The prosecution's expert, a certified forensic video analyst, testified that his focus is on image integrity, rather than the smoothness or attractiveness of the image, and that Topaz added approximately sixteen times the number of pixels than contained in the original source image. The expert demonstrated that Topaz creates "false image detail" which changed the meaning of portions of the video, including altering the shape and color of certain objects. He testified that Topaz removed information from the source video and replaced it with information not contained in it, which prevented the ability to forensically analyze the video. He further noted that Topaz "used an algorithm and enhancement method unknown to and unreviewed by any forensic video expert."

The court stated that, given the "novelty" of the technique, the proponent of the party using such an AI tool must make a "showing that the expert's opinion or theory is based on a methodology accepted in the relevant community" (because Washington is a *Frye* state) and, in this case, the AI technology is not generally accepted by that community. The court stated that the AI-enhanced video "does not show with integrity what actually happened but uses opaque methods to represent what the AI 'thinks' should be shown."

> ***Reporter's Comment:*** The court is obviously not saying that "AI is inadmissible." Rather, AI, to be admissible, must be properly validated like any other expert evidence. The big problem here was that the software was being used for a purpose for which it was not really intended --- a problem called "function creep." There is ample authority in Rule 702 to exclude such misapplied expertise. There are many cases in which an expert has been excluded when applying a methodology to an inquiry for which the methodology was not intended. *See, e.g.*, *Braun v. Lorillard, Inc.*, 84 F.3d 230 (7th Cir. 1996) (expert testimony properly excluded where the expert applied tests to human tissues when the test was designed to detect asbestos in building materials).

- **Cases Rejecting ChatGPT-based Evidence:**

A number of recent courts have rejected evidence that was generated by ChatGPT. For example, the court in *J.G. v. New York City Dept. of Educ.*, 2024 WL 728626 (S.D.N.Y. Feb. 22, 2024) rejected the use of AI to substantiate hourly rate data in order to support an attorneys' fee application, stating:

> In claiming here that ChatGPT supports the fee award it urges, the Cuddy Law Firm does not identify the inputs on which ChatGPT relied. It does not reveal whether any of these were similarly imaginary. It does not reveal whether ChatGPT anywhere considered a very real and relevant data point: the uniform bloc of precedent, canvassed below, in which courts in this District and Circuit have rejected as excessive the billing rates the Cuddy Law Firm urges for its timekeepers. The Court therefore rejects out of hand ChatGPT's conclusions as to the appropriate billing rates here. Barring a paradigm shift in the reliability of this tool, the Cuddy Law Firm is well advised to excise references to ChatGPT from future fee applications.

See also S. v. New York City Dept. of Educ., 2024 WL 2159785 at *6 (S.D.N.Y. Apr. 29, 2024), (report and recommendation) ("Specifically, CLF references the artificial intelligence tool "ChatGPT." CLF relies on ChatGPT's feedback to demonstrate what a client's search may provide when attempting to determine hourly rates for IDEA litigation. Here, CLF's reliance on ChatGPT is inappropriate, because ChatGPT has been shown to be an unreliable resource.").

- **Copyright Case Applying Rule 702 to AI: *Bertuccelli v. Universal City Studios LLC***, 2020 WL 6156821 (E.D. La. Oct. 21, 2020). This is a case in which facial recognition technology was used to determine whether competing Mardi Gras masks were substantially similar. The court allowed the AI-based testimony.

> The Court also finds Dr. Griffor is qualified to testify as an expert. Dr. Griffor is the Associate Director for Cyber-Physical Systems at the National Institute of Standards and Technology (NIST) in Washington, DC, and holds a Ph.D. in Mathematics from the Massachusetts Institute of Technology, and a Habilitation/European Doctor's Degree in Electrical Engineering and Mathematics from the University of Oslo. Dr. Griffor has experience with algorithmic reasoning for artificial intelligence-enabled driving systems, including facial recognition technology and is considered an expert in the field of facial target recognition. The Court finds Dr. Griffor's methodology reliable given that he conducted an artificial intelligence assisted facial recognition analysis of the King Cake Baby and Happy Death Day mask to determine whether the use of mathematics and target facial recognition algorithms comparing the two works would find that human perception would view the works as substantially similar. Accordingly, the Court finds Dr. Griffor is qualified to testify as an expert in this case.

- **Court Rejects Deeper Inquiry into AI Program: *United States v. Nelson*, 533 F. Supp. 3d 779, 798 (N.D. Cal. 2021)**: In a racketeering case, the defendant challenged an expert's testimony on cell-site location. The particular program used was called "Enterprise Sensor Processing Analytic" (ESPA). The defendant argued that he was entitled to a more detailed description of, and access to, the software. The court rejected the challenge. It stated that "the apparent absence of any inaccuracies in Ms. Sparano's presentation strongly suggests that even if ESPA operates like a 'black box,' the defendants have not been harmed by their lack of direct access to the program." It concluded that the demand for more information about the AI program would essentially open the floodgates:

> Informing the Court's conclusion are the sweeping and counterintuitive implications of Defendants' position on the ESPA issue. If courts required expert witnesses to possess expert knowledge of "the software used to generate" demonstrative exhibits such as maps, as Defendants suggest they should, then law-enforcement and intelligence officials would almost always be barred from relying on such commonplace exhibits at trial. Similarly, anyone who testifies using any basic software such as Excel to provide financial analysis would be required to be an expert in the algorithms by which Excel codes its formula and calculations. As a result, no expert utilizing any technological tools would be permitted to testify without also being an expert software engineer. The Federal Rules of Evidence do not mandate such an absurd result.

II. Proposals for Rule Amendments

There are several proposals for AI-related rules amendments for the Committee's consideration. Some of these have already been set forth in the memo for the Spring meeting; but because they were not formally and specifically considered, they are included here again. Others are revisions in response to the Committee’s prior review of the proposal.

The question for the Committee is whether any or these proposals merits further development and formal presentation with a proposed Committee Note at a later meeting.

A. REVISED Proposed Modification of Current Fed. R. Evid. 901(b)(9) for AI Evidence and Proposed New Fed. R. Evid. 901(c) for Alleged “Deepfake” Evidence

Submitted by Paul W. Grimm and Maura R. Grossman

[901](b) **Examples**. The following are examples only—not a complete list—of evidence that satisfies the requirement [of Rule 901(a)]:

(9) *Evidence about a Process or System*. For an item generated by a process or system:

(A) evidence describing it and showing that it produces ~~an accurate~~ **a valid and reliable** result; and

(B) if the proponent acknowledges that the item was generated by artificial intelligence, additional evidence that:

(i) describes the training data and software or program that was used; and

(ii) shows that they produced valid and reliable results in this instance.

Proposed New Rule 901(c) to address "Deepfakes":

901(c): ***Potentially Fabricated or Altered Evidence Created By Artificial Intelligence.***

If a party challenging the authenticity of computer-generated or other electronic evidence demonstrates to the court that a jury reasonably could find that the evidence has been altered or fabricated, in whole or in part, by artificial intelligence [3], the evidence is admissible only if the proponent demonstrates that its probative value outweighs its prejudicial effect on the party challenging the evidence.

Supporting Statement by Grimm and Grossman

Amendment to Rule 901(b)(9)

Given the complexities and challenges presented by using AI-generated evidence, rule changes that set a standard for what is sufficient to authenticate such evidence would be extremely helpful. Because AI-generated evidence is, by definition, evidence produced by a system or process, the proposal adds a subsection (B) to existing Fed. R. Evid. 901(b)(9) to set a standard for authenticating evidence that the proponent acknowledges is AI-generated. The proposed revision substitutes the words "valid" and "reliable" for "accurate" in existing Rule 901(b)(9), because evidence can be "accurate" in some instances but inaccurate in others (such as a broken watch that "accurately" tells the time twice a day, but is otherwise not a reliable means of ascertaining the time). In addition, the terms "valid" and "reliable" are less vague and ambiguous than the term "accurate," and are the terms used in the relevant scientific community. Similarly, "reliability" of scientific, technical, and specialized methodology is the standard required by Fed. R. Evid. 702 for admissibility of expert evidence.

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[3] "There is no single definition of artificial intelligence. At its essence, AI involves computer technology, software, and systems that perform tasks traditionally requiring human intelligence. The ability of a computer or computer-controlled robot to perform tasks commonly associated with intelligent beings is one definition. The term is frequently applied to the project of developing systems that appear to employ or replicate intellectual processes characteristic of humans, such as the ability to reason, discover meaning, generalize, or learn from past experience." ABA Standing Committee on Ethics and Professional Responsibility, Formal Opinion 512. Generative Artificial Intelligence Tools, July 29, 2024, at note 1 (internal citations omitted). Generative AI "(GAI) . . . can create various types of new content, including text, images, audio, video, and software code in response to a user's prompts and questions." *Id* at 1 (citing George Lawton, *What is Generative AI? Everything you Need to Know*, TechTarget (July 12, 2024), https://techtarget.com/searchenterpriseai/definition/generative-AI).

For acknowledged AI-generated evidence, the proposed rule change would identify a sufficient means for authentication of that evidence. It would require the proponent to (i) describe the training data and software or program that was used to create the evidence, and (ii) show that it produced *valid* and *reliable* results in the particular case setting in which it is being offered. *Valid* evidence is evidence that produces accurate results, meaning that the AI system or process measures or predicts what it is designed to measure or predict, and *reliable* evidence is that which produces consistently accurate results when applied to similar facts and circumstances. Both are necessary to ensure authenticity of AI-generated evidence, but the terms "accurate" or "reliable" alone do not clearly convey that.

Addition of New Rule 901(c)

A separate, new rule is required to address the relatively recent phenomenon of AI-generated "deepfakes," which, due to rapidly improving generative AI software applications, are capable of altering existing or producing fabricated images, videos, audio recordings, or audiovisual recordings that are so realistic that it is becoming increasingly difficult to differentiate between authentic evidence and altered or fabricated evidence. A separate, new rule is needed for such altered or fake evidence, because when it is offered, the parties will disagree about the fundamental nature of the evidence. The opposing party will challenge the authenticity of the evidence and claim that it is AI-generated material, in whole or in part, and therefore, fake, while the proponent will insist that it is not AI-generated, but instead that it is simply a photograph or video (for example, one taken using a "smart phone"), or an audio recording (such as one left on voice mail), or an audiovisual recording (such as one filmed using a digital camera). Because the parties fundamentally disagree about the very nature of the evidence, the proposed rule change for authenticating acknowledged AI-generated evidence will not work.

Our proposal creates a new Fed. R. Evid. 901(c), as opposed to an addition to Rule 901(b)(9). The proponent of evidence challenged as AI-generated material may choose to authenticate it by many means other than Rule 901(b)(9), which focuses on evidence generated by a "system or process." For example, the proponent might choose to authenticate an audio recording under Fed. R. Evid. 901(b)(5) (opinion as to voice) or Fed. R. Evid. 901(b)(3) (comparison of evidence known to be authentic with other evidence the authenticity of which is questioned). The new Rule 901(c) would cover all deepfake disputes regardless of how the item is purportedly authenticated.

The proposed new rule does not use the word "deepfake," because it is not a technical term, but rather describes evidence that is either "computer-generated" (which encompasses AI-generated evidence) or "electronic evidence," which encompasses other forms of electronic evidence that may not be AI-generated (such as digital photographs or recordings).

The proposed new rule places the burden on the party challenging the authenticity of computer-generated or electronic evidence as AI-generated material to make a showing to the court that a jury reasonably could find (but is not required to find) that it is either altered or fabricated, in whole or in part. This approach recognizes that the facts underlying whether the evidence is authentic or fake may be challenged, in which case the judge's role under Fed. R. Evid. 104(a) is limited to preliminarily evaluating the evidence supporting and challenging authenticity, and determining whether a reasonable jury could find by a preponderance of the evidence that the proffered evidence is authentic. If the answer is "yes" then, pursuant to Fed. R. Evid. 104(b), the judge ordinarily would be required to submit the evidence to the jury under the doctrine of relevance conditioned upon a finding of fact, *i.e.*, Fed. R. Evid. 104(b).

But because deepfakes are getting harder and harder to detect, and because they often can be so graphic or have such a profound impact that the jury may be unable to ignore or disregard the impact even of generative AI shown to be fake once they have already seen it, a new rule is warranted that places more limits on what evidence the jury will be allowed to see. *See generally* Taurus Myhand, *Once The Jury Sees It, The Jury Can't Unsee It: The Challenge Trial Judges Face When Authenticating Video Evidence in The Age of Deepfakes*, 29 Widener L. Rev. 171, 174-5 (2023) ("The dangerousness of deepfake videos lie in the incomparable impact these videos have on human perception. Videos are not merely illustrative of a witnesses' testimony, but often serve as independent sources of substantive information for the trier of fact. Since people tend to believe what they see, 'images and other forms of digital media are often accepted at face value.' 'Regardless of what a person says, the ability to visualize something is uniquely believable.' Video evidence is more cognitively and emotionally arousing to the trier of fact, giving the impression that they are observing activity or events more directly.") (Internal citations omitted).

If the judge is required by Fed. R. Evid. 104(b) to let the jury decide if image, audio, video, or audiovisual evidence is authentic or fake when there is evidence supporting each outcome, the jury is then in danger of being exposed to evidence that they cannot "un-remember," even if the jurors have been warned or believe it may be fake. This presents an issue of potential prejudice that ordinarily would be addressed under Fed. R. Evid. 403. But Rule 403 assumes that the evidence is "relevant" in the first instance, and only then can the judge weigh its probative value against the danger of unfair prejudice. But when the very question of relevance turns on resolving disputed evidence, the current rules of evidence create an evidentiary "Catch 22" --- the judge must let the jury see the disputed evidence on authenticity for their resolution of the authenticity challenge (*see* Fed. R. Evid. 104(b)), but that exposes them to a source of evidence that may irrevocably alter their perception of the case even if they find it to be inauthentic.

The proposed new Fed. R. Evid. 901(c) solves this "Catch 22" problem. It requires the party challenging the evidence as altered or fake to demonstrate to the judge that a reasonable jury could find that the challenged evidence has been altered or is fake. The judge is not required to make the finding that it is, only that a reasonable jury could so find. This is similar to the approach that the Supreme Court approved regarding Fed. R. Evid. 404(b) evidence (*i.e.*, other crimes, wrongs, or acts evidence) in *Huddleston v. United States*, 108 S. Ct. 1496, 1502 (1988) and the Third Circuit approved regarding Fed. R. Evid. 415 evidence (*i.e.*, similar acts in civil cases involving sexual assault or child molestation) in *Johnson v. Elk Lake School District*, 283 F. 3d 138, 143-44 (3d. Cir. 2002).

Under the proposed new rule, if the judge makes the preliminary finding that a jury reasonably could find that the evidence has been altered or is fake, the judge would be permitted to exclude the evidence (without sending it to the jury), *but only if the proponent of the evidence cannot show that its probative value exceeds its prejudicial impact*. The proponent could make such a showing by offering additional facts that corroborate the information contained in the challenged image, video, audio, or audiovisual material. This is a fairer balancing test than Fed. R. Evid. 403, which leans strongly towards admissibility. Further, the proposed new balancing test already is recognized as appropriate in other circumstances. *See, e.g.*, Fed. R. Evid. 609(a)(1)(B) (requiring the court to permit a criminal defendant who testifies to be impeached with a prior felony conviction only if "the probative value of the evidence outweighs its prejudicial effect to that defendant").

The proposed new rule has other advantages as well. While it requires the party challenging the evidence as a deepfake to demonstrate facts (not conclusory or speculative arguments) from which the judge could find that a reasonable jury *could* find the evidence to be altered or fake, this does not require them to persuade the judge that it actually has been altered or is fake, which lessens the burden on the challenging party to make a sufficient initial challenge. Under an approach already recognized in *Huddleston* and *Johnson*, the proposed new rule only requires the judge to determine whether a jury reasonably could find that the evidence was altered or fake, at which time the proponent would then be required to show that the probative value of the evidence is greater than its potential prejudicial impact. This determination would be made by the judge.

Finally, the proposed new rule also has the benefit of not imposing any initial obligation on the proponent of the evidence to authenticate the evidence in any particular way. The proponent can choose from any of the authentication methods illustrated in Fed. R. Evid. 901(b) and 902, or any other means of showing that the evidence is what it purports to be. If, under the new proposed rule, the party challenging the evidence as a deepfake then succeeds in making the showing that the trier of fact reasonably could find the challenged evidence to be altered or fake, the proponent would then have an opportunity to corroborate or bolster the authenticating evidence, and the judge would then apply the new balancing test. This fairly allocates the competing burdens on the proponent and challenging parties and outlines the role of the judge in screening for unfair prejudice without the need to send the disputed facts and potentially misleadingly prejudicial evidence to the jury.

Reporter's Comment on the Grimm/Grossman Revised Proposal:

The proposal addresses the two major evidentiary concerns posed by AI: 1. The proposal to amend Rule 901(b)(9) addresses the reliability of machine learning output; and 2. New Rule 901(c) provides a process for dealing with deepfakes, and gives the court a means for handling a blanket "it's a deepfake" claim for every audio and video. If the Committee decides to address AI, the Grimm/Grossman proposal has a lot of merit. It is concise, it sets forth a structure, and it is well-crafted. It is, at the very least, a great starting point.

There are some questions to answer in reaching agreement on this rule, however:

1) General Point About Coverage. There is a problem in defining the coverage of the proposal. Originally the proposal was written to cover all "computer-generated" evidence. My response to that proposal was that it would cover a lot of evidence that is not deepfake-related or machine-learning created. For example, over the last 20 years there have been hundreds of examples of litigants arguing that "somebody hacked into my Facebook account"; "somebody faked my text", etc. *See, e.g.*, *United States v. Recio*, 884 F.3d 230 (4th Cir. 2018) (Facebook posts found authentic over an unsubstantiated claim by the defendant that his account was hacked); *United States v. Peterson*, 945 F.3d 144 (4th Cir. 2019) (defendant may not demonstrate to the jury how easy it is to fake a text, where there was no indication that the defendant was a victim of text manipulation). All of the social media/text/email evidence is "computer-generated" and charges of "faking" have been well-handled by the courts. It could be disruptive to apply a new standard to social media-type evidence when the goal is to address AI deepfakes. That is true both for Rule 901(b)(9) and 901(c) --- but especially for 901(c), which would apply an extra step of having to find that probative value outweighs prejudice, which the courts are definitely not doing for claims of Facebook hacking.

That means that the coverage of the rule should be specifically addressed to AI-generated evidence. But that creates a new problem, because there is some dispute about what the term "Artificial Intelligence" covers --- and the term is dynamic. It's an umbrella term that may cover different processes in the future. (For example, what we have now is "Narrow AI" developed as an aid to human thought. But what is in the offing is "Artificial General Intelligence" which greatly exceeds the cognitive performance of humans.)

The problem of describing proper coverage is not fatal, though. AI could be defined well enough in a Committee Note, and the term "artificial intelligence" is used sufficiently frequently in discourse, that it may be workable for a rule. The fact that computer nerds might quibble with the term does not mean it is unworkable for courts and litigants. In the end, it seems important to limit the amendment to AI-generated evidence, as opposed to all computerized evidence, as that broader term is likely to be disruptive of existing case law. Whether the term "artificial intelligence" is used, and whether an alternative term is better, is the kind of question that might well benefit from public comment.

It is notable that the proposed AI legislation in New York uses the term "artificial intelligence" throughout. It also uses, as a kind of equivalent, the term "automated system." Perhaps that is an alternative that can be used if the Committee goes forward with an amendment (although "automated system" would seem to cover social media as well).

The proposed amendments set forth below use the term "artificial intelligence" as an alternative, with an explanation in the Committee Note of what is intended by the term.

2) Rule 901(b)(9): The proposal to amend Rule 901(b)(9) essentially seeks to impose reliability guarantees on machine learning outputs. One problem with adding reliability requirements to *authentication* standards is that you are stuck with the low Rule 104(b) standard --- unless you want to specifically change it, which Grimm and Grossman do not suggest. More importantly*, authenticity is not about reliability*. It is about whether the item is what you say it is. If I wanted to admit a document that is probative *because* it is false and unreliable, I would authenticate by showing that it was prepared in an unreliable manner. If I wanted to admit a ChatGPT transmission *because* it was a hallucination, I would not be trying to show a system that leads to reliable results.

When we think of reliability problems inherent in machine learning, the better analog is surely Rule 702. There, the proponent must satisfy a preponderance standard. And Rule 702-type principles are obviously pertinent because the jury will treat machine learning output as the equivalent of expert testimony. And those 702-type standards are the ones being applied by courts to machine learning evidence today.[4] That 702 analysis works well when there is a live expert testifying to the machine learning output. While Rule 702 refers to "witnesses" and machines are not really witnesses, the solution for admitting machine-learning evidence without witness accompaniment could be to have an independent rule specifically about machine learning that incorporates the reliability requirements of Rule 702. That alternative --- a new Rule 707 --- is discussed below.

Thus, it seems like amending Rule 901(b) is not the optimal solution for machine learning evidence. It could be argued, though, that the specific reliability requirements of the Grimm-

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[4] *See, e.g.*, *Washington v. Puloka*, No. 21-1-04851-2 (Super. Ct. Kings Co. Wash. 2024) (applying expert reliability requirements to machine learning outputs).

Grossman proposal might be useful as a kind of belt and suspenders regulation of machine learning evidence. Though it seems complex to have two separate reliability requirements covering the same piece of evidence, one applying Rule 104(a) and the other applying Rule 104(b).

But let's assume that Rule 707 is not proposed, and let's assume the Committee wants to propose a rule to regulate machine-learning evidence. If all that is so, then some reliability standards to cover machine evidence could be placed in Rule 901(b)(9). The Grimm-Grossman proposal is a good starting point because it helpfully requires a description of the software and a demonstration of how it reached a reliable result in this instance.

But some questions remain. First, the proposal distinguishes the terms "validity," "reliability," and "accuracy." Those distinctions are complicated. As to validity and reliability, the current rules --- most importantly Rule 702 --- use the term reliability. Certainly there are those who can draw a distinction between validity and reliability, but is it worth it? As Grimm and Grossman describe it above, the term "validity" is just a subset of "reliability" and there would be little payoff in making that distinction.

The term "validity" is used in the Evidence Rules only in the context of "validity of the claim" as in Rule 408. In this proposal, validity is used as a scientific term and it does not appear that it adds much to the rule. Thus the Committee may wish to *delete the reference to validity* and stay with "reliability."

As to "accuracy," the proposal rejects the term, but in fact there is a good deal of material on machine learning that emphasizes "accuracy." *See, e.g.*, https://www.evidentlyai.com/classification-metrics/accuracy-precision-recall ("Accuracy is a metric that measures how often a machine learning model correctly predicts the outcome. You can calculate accuracy by dividing the number of correct predictions by the total number of predictions. In other words, accuracy answers the question: how often the model is right?"). Grimm and Grossman say that a broken clock is accurate twice a day, but all that means is that it has a low rate of accuracy. That doesn't seem on its own to be a reason to delete the term "accuracy" from the existing text. It is notable that the definition of "validity" and "reliability" propounded by Grimm and Grossman above both use the term "accurate."

On the other hand, using "accuracy" and "reliability" as different terms in the same rule may well result in confusion. The goal is to describe the requirement in a way that is basically correct and commonly understood by lawyers and judges. The whole area is complicated enough without adding distinctions that may not make a difference.

Probably the best result is to stick with the single term “reliable” throughout. That is certainly the best connection to Rule 702-type principles. That is the solution employed in the drafting alternatives at the end of this memo.

3) The Need for Rule 901(c): The proposed Rule 901(c) addresses an important problem: how to regulate an automatic objection “it's a deepfake” for every offered audio or visual presentation. The question is whether those blanket claims present a problem that might be handled by the courts under the existing Rule 901. As discussed below, a similar concern arose during the rise of texts and social media: the concern that every opponent would argue “my Facebook post was hacked, my text was hacked” and so on. It turned out that courts handled that wave of objections by holding that something more than a mere assertion was necessary before an inquiry would be taken into the authenticity of texts and social media. Courts have specifically rejected blanket claims like “my account was hacked” --- because such an argument can always be made. Thus, courts have consistently held that “the mere allegation of fabrication does not and cannot be the basis for excluding ESI as unauthenticated as a matter of course, any more than it can be the rationale for excluding paper documents.”[5] Courts properly require some showing from the opponent before inquiring into charges of hacking and falsification of digital information.[6] The opponent has a burden of going forward.

The question is whether courts will similarly be able to handle blanket claims of “it’s a deepfake” under the existing rule. There are good arguments on both sides. The argument for no change is that courts handled the previous wave just fine, so there is no need to be concerned about such blanket arguments when it comes to deepfakes. The argument for a new rule is that deepfakes are extremely hard to detect, and while hacking Facebook posts might be a rare occurrence, the potential use of deepfakes could well be broader and wider. Moreover, a concrete standard for justifying an inquiry --- such as that set forth in the proposal --- could be more useful to the court than the general standards that can be found only in the case law. Grimm and Grossman set forth a specific standard necessary to trigger a deepfake enquiry (i.e., a prima facie case of AI distortion); the courts currently do not use a specific uniform standard to trigger an enquiry into fakery.

One could argue that resolving the argument about the necessity of the rule should be delayed until courts actually start dealing on a regular basis with deepfakes. At that point it can be determined how necessary a rule amendment really is. Moreover, the possible prevalence of deepfakes might be countered in court by the use of watermarks and hash fingerprints that will assure authenticity. Again, the effectiveness of these countermeasures will only be determined after a waiting period.

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[5] *United States v. Safavian*, 435 F. Supp. 2d 36, 38 (D.D.C. 2006).

[6] *See* Grimm, Capra and Joseph, *Authenticating Digital Evidence,* 69 Baylor L. Rev. 1, 3-5 (2017) (reviewing the showing necessary for an inquiry into falsification of digital evidence).

That said, the slowness of the rulemaking process might ironically be a factor that would justify action at the next meeting. The Committee could propose a rule for public comment at the next meeting, and it would be another whole year before the Committee would revisit the rule. If there was no significant deepfake activity in the courts by then, that would be a reason to pause. If courts were having trouble with deepfakes during that year, that could be a reason to keep going. And the public comment on an AI proposal is sure to be massive and hopefully helpful. So there is much to be said for agreeing upon language and putting out a proposal at the next meeting.

4) The Rule 901(c) Trigger: Assuming that courts could use help to deal with blanket claims of "deepfake," the *first step* provided by Grimm and Grossman is a very good one: the opponent must provide evidence sufficient for a reasonable person to find that the item is a deepfake. That prima facie standard is part of the revision of the proposal previously submitted to the Committee. At the last meeting, the proposal required the proponent to show *more likely than not* that the item is a deepfake, and the Committee found that that standard was too high. Reducing the standard to a prima facie case makes sense as an accommodation between the parties. It means that enquiries will not be automatic, but also that they will not be too hard to trigger. That's a big step forward.

5) The Rule 901(c) Balancing Test: The balancing test in the proposal --- applied when the burden-shifting trigger is met --- is that the "probative value" must outweigh the "prejudicial effect." It seems, though, that importing this standard confuses authenticity with the probative value and prejudicial effect attendant to the item itself. Authenticity is a question of conditional relevance, whereas probative value is about assessing how far the content of the item advances the case *once it has been found authentic*. If a picture shows a defendant punching a victim, in an assault prosecution, it is undeniably highly probative and not prejudicial at all. What about if it is fake? That is a question of authenticity, which is one of *conditional relevancy.* It is relevant only if it is authentic. Does it work to then make this question of conditional relevance dependent on a showing that probative value substantially outweighs the prejudice? It arguably confuses matters. Put another way, the probative value of the evidence can only logically be assessed *after* it is determined to be authentic. Having authenticity depend on probative value is a pretty complicated endeavor. A court should not have to balance probative value and prejudicial effect as part of the deepfake inquiry, and then apply Rule 403 to the content of the item.

In fact it is hard to see what the court is to consider when balancing probative value and prejudicial effect at the authenticity level. What exactly would be prejudicial? Presumably it would be something independent of the content of the item. Perhaps the prejudice is that the jury would find something to be authentic when in fact it was a deep fake. But isn't that exactly what the court is determining when it decides that the item is authentic? Maybe the response would be that the decision is made at the low Rule 104(b) level. But surely the more direct solution is to ratchet up the standard of proof so as to reduce the "prejudice," not to worry about prejudicial effect that will occur when the jury sees the evidence and thinks it is authentic when it is not. And what exactly is the probative value that is evaluated at the authenticity level? It is not about the content itself, as that would be a separate Rule 403 question. Rather it must be the strength of the inference that the item is not a deepfake. But again, this is what is to be decided at the authenticity level; there is no point in talking about "probative value" in this way, independent of the content of the item.

At any rate, there is nothing in the text of the proposal which helps the court to figure out what probative value and prejudicial effect is supposed to mean at the authenticity level. So a Committee Note will have to try to explicate what is a very complicated, two-level use of probative value and prejudicial effect --- once as to authenticity and then once as to the content of the item.

An alternative that stays within the confines of authenticity is to provide that once the opponent makes a showing sufficient to justify an inquiry, i.e., "enough for the jury to find that the item was generated by artificial intelligence" then the proponent has the burden of showing the court, under Rule 104(a), that it is *more likely than not that the item is authentic.* Such a proposal would read as follows:

> **If a party challenging the authenticity of computer-generated or other electronic evidence demonstrates to the court that a jury reasonably could find that the evidence has been altered or fabricated, in whole or in part, by artificial intelligence [by an automated system], the evidence is admissible only if the proponent demonstrates to the court that it is more likely than not authentic.**

This burden-shifting alternative on the question of authenticity --- once the opponent has made a prima facie case, the proponent has to establish authenticity more likely than not --- may be questioned because it imports a Rule 104(a) standard for an authenticity question, while all other authenticity questions are decided under Rule 104(b). But that differentiation may be justified by the problems inherent in detecting deepfakes. And heightening the standard makes sense after the opponent has provide a prima facie case of fakery. After that triggering requirement is met, the proponent should have to show *something* more than the Rule 104(b) standard of authenticity. The logical conclusion is that the proponent must show authenticity by a preponderance of the evidence. Note that the Rule 104(a) standard only applies if the opponent makes the initial showing of fakery. If that showing is not made, then the proponent authenticates under the Rule104(b) standard.

B. Professor Roth's Proposed Amendments to Address Machine Learning Evidence

At a Committee meeting last year, Professor Andrea Roth proposed changes to the Federal Rules to give courts the tools to regulate machine-learning output. In broad summary, her basic concern is that now many machines are thinking like people, and are making out of court statements like people would. For real people, the solution to such out of court statements is cross-examination. But the hearsay rule does not work well for machine-based outputs, because machines cannot be cross-examined. So in the absence of hearsay regulation, what can be added to the rule that would regulate the reliability problems inherent in machine-generated information? (Those problems include subjective selection and interpretation of data, contextual bias, applying learning to areas not originally envisioned, and inaccessibility to source codes and data collection practices).

Professor Roth initially proposed an addition to Rule 702, as seen below. After discussions with the Reporter, another alternative was put forth --- a new Rule 707. Both proposals are discussed immediately below.

1. Proposed amendment to Rule 702 (and in the alternative, a free-standing rule incorporating Rule 702 standards for machine-learning).

Professor Roth recommends as one alternative an addition to Rule 702. It would be a new subdivision, independent from the current rule. This would require some stylistic reconstruction of the existing rule. The proposed addition is as follows:

> 2) Where the output of a process or system would be subject to part (1) if testified to by a human witness, the proponent must demonstrate to the court that it is more likely than not that:
>
> (A) The output will help the trier of fact to understand the evidence or to determine a fact in issue;
>
> (B) The output is based on sufficient and pertinent inputs and data, and the opponent has reasonable access to those inputs and data;
>
> (C) The output is the product of reliable principles and methods; and
>
> (D) The output reflects a reliable application of the principles and methods to the facts of the case, based on the process or system's demonstrated reliability under circumstances or conditions substantially similar to those in the case.

(3) The output of basic scientific instruments and tools are not subject to the requirements of this rule.

Reporter's Comment

1. The proposal addresses what appears to be a gap in the rules. Expert witnesses must satisfy reliability requirements for their opinions, but it is a stretch, to say the least, to call machine learning output an "opinion of an expert witness." Machine output is explicitly regulated today, as a matter of authenticity, by Rule 901(b)(9): the proponent must show that evidence of a machine process "produces an accurate result." But that authenticity standard is the mild one of Rule 104(b). And nothing in Rule 901(b) specifically requires the kind of showing on reliability that must be made with respect to a human expert under Rule 702. The goal of the proposal is to apply *Daubert*-like requirements to machine learning evidence.

2. Professor Roth's proposal basically applies the existing Rule 702 to machine learning. The additions are that: a) facts or data is now "inputs and data"; b) the opponent must have reasonable access to those inputs and data; and c) the reliable application prong must be evaluated "based on the process or system's demonstrated reliability under circumstances or conditions substantially similar to those in the case." There is a good argument that these are helpful tweaks, but perhaps they are sufficiently well-placed in the Note if the payoff is a less complicated drafting solution. See possible Rule 707 below for the simpler alternative. (Also, as discussed elsewhere in this memo, a requirement of reasonable access to inputs and data may raise questions of jurisdiction with the Criminal and Civil Rules Committees.)

3. There is a rulemaking problem in amending Rule 702 so soon after the 2023 amendment. Generally it is a bad idea to keep tinkering with a rule. That could be explained here by the fact that AI-related evidence is a concept that exploded only recently --- after the 2023 amendment had been proposed for public comment. All that said, if the Committee is interested in a Rule 702-type solution to AI evidence, then the better path is probably to add a completely new rule to govern machine-learning evidence. *See* draft Rule 707, below.

4. The new rule alternative would incorporate the Rule 702 standards whenever a machine makes a statement that would be expert testimony if coming from a human. The basis for such a rule would be that the concerns about machine-learning are reliability-based. Ben Studdard, in the Georgia Handbook on Criminal Evidence, puts it this way:

> The issues implicated in AI-generated evidence are remarkably similar to those raised by Rule 702, which governs the admissibility of expert opinion testimony. * * * It would seem logical for courts to apply a similar analysis to AI-generated evidence. Perhaps in the future an analogous rule will be written to cover what will undoubtedly become a common category of evidence.

Here is what a new rule could look like:

Rule 707. Machine-generated Evidence

> Where the output of a process or system would be subject to Rule 702 if testified to by a human witness, the court must find that the output satisfies the requirements of Rule 702 (a)-(d). This rule does not apply to the output of basic scientific instruments or routinely relied upon commercial software.

Reporter's Comment:

It doesn't help to restate all the Rule 702 requirements in this new rule. And if different standards were articulated, questions would be created about how to handle an overlap. Thus a simple absorption of Rule 702 avoids difficult textual problems of either repeating or subtly changing the Rule 702 requirements as applied to machine-learning.

You could add guidance in the Committee Note to describe just how the machine data should be evaluated at a *Daubert* hearing --- including, if Committee members agree, a statement that the opponent must get reasonable access to the inputs and data.

The last sentence of the text is to assure that the rule is not needed when the output is simple machine data, (e.g., an altimeter) or basic software (e.g. Excel). Though it might be sufficient to make that statement in the Committee Note rather than text, because it seems extremely unlikely for a court to look at this rule and say, "yes, let's do a *Daubert* hearing on the thermometer reading."

Here is a draft Committee Note for the Rule 707 alternative.[7]

Draft Committee Note

Expert testimony in modern trials increasingly relies on software- or other machine-based conveyances of information, from software-driven blood-alcohol concentration results to probabilistic genotyping software. Machine-generated evidence can involve the use of a computer-based process or system to make predictions or draw inferences from existing data. When a machine draws inferences and makes predictions, there are concerns about the reliability of that process, akin to the reliability concerns about expert witnesses. Problems include using the process for purposes that were not intended (function creep); analytical error or incompleteness; inaccuracy or bias built into the underlying data or formulas; and lack of interpretability of the machine's process. Where an expert relies on such a method, the method – and the expert's reliance on it – will be scrutinized pursuant to Rule 702. But if machine or software output is presented on its own, without the accompaniment of a human expert, Rule 702 is not obviously applicable. Yet

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[7] Thanks to Professor Andrea Roth and Dr. Timothy Lau for their assistance in correcting my mistakes in the first draft of this Note.

it cannot be that a proponent can evade the reliability requirements of Rule 702 by offering machine output directly, where the output would be subject to 702 if rendered as an opinion by a human expert. Therefore, new Rule 707 provides that if machine output is offered directly, it is subject to the requirements of Rule 702 (a)-(d).

It is anticipated that a Rule 707 analysis will involve the following, where applicable:

• Considering whether the inputs into the process are sufficient for purposes of ensuring the validity of the resulting output. For example, the court should consider whether the training data for a machine learning process is sufficiently representative to render an accurate output for the population involved in the case at hand.

• [Ensuring that the opponent has been provided sufficient access to the program, and that independent researchers have had sufficient access to the program, to allow both adversarial scrutiny and sufficient peer review beyond simply validation studies conducted by the developer or related entities. Where a developer has declined to make a research license or equivalent access widely available to independent researchers, courts should be wary of allowing output from such a process.]

• Considering whether the process has been validated in circumstances sufficiently similar to the case at hand. For example, if the case at hand involves a DNA mixture of several contributors, likely related to each other, and a low quantity of DNA, the software should be shown to be valid in those circumstances before being admitted.

The final sentence of the rule is intended to give trial courts sufficient latitude to avoid unnecessary litigation over machine output that is regularly relied upon in commercial contexts outside litigation and that, as a result, is not likely to render output that is invalid for the purpose it is offered. Examples might include the results of a mercury-based thermometer, battery-operated digital thermometer, or automated averaging of data in a spreadsheet, in the absence of evidence of untrustworthiness.

The Rule 702(b) requirement of sufficient facts and data, as applied to machine-generated evidence, should focus on the information entered into the process or system that leads to the output offered into evidence.

■■

2. Proposed amendment to Rule 806. Professor Roth suggests that Rule 806 be amended to allow opponents to "impeach" machine output in the same way as they would impeach hearsay testimony from a human witness. She proposes an additional subsection to Rule 806:

(2) When output of a process or system has been admitted in evidence, and would be a hearsay statement if uttered by a human declarant, the output's accuracy may be attacked, and then supported, by any evidence that would be admissible for those purposes if the output had been uttered by a human declarant. The court may admit evidence of the process or system's inconsistent output, or prior false output where probative of the admitted output's accuracy, for these purposes as well.

Reporter's Comment: The goal here is to treat machine learning --- which is thinking like a human --- the same way that a human declarant may be treated. But not all forms of impeachment are properly applicable to machine learning. For example, it would seem that a machine doesn't have a character for truthfulness; prior convictions and bad acts of a machine do not exist. Presumably the machine could make a prior inconsistent statement. A machine output could be contradicted. A machine output can definitely be impaired by bias, at least speaking broadly, if it is relying on data that is affected by bias. And finally, it seems unlikely that a machine can be impeached by incapacity (ability to recall and relate).

The question is whether a confusing signal is given by applying Rule 806 wholesale to machine-learning evidence, when in fact not all the forms of impeachment are workable as applied to machines. There is a good argument that any type of "impeachment" of machines that can occur is already governed as to human witnesses by Rule 403. If, for example, the opponent wants to admit prior inconsistent or false output of a machine, that is certainly relevant evidence and the court doesn't need a special rule to admit it. (It's not barred by the hearsay rule because it is offered to show inconsistency or falsity, not underlying truth.) And impeachment of a witness for bias and contradiction are already covered by Rule 403 anyway, and so, by analogy, that rule should apply to bias and contradiction evidence with respect to machine learning. In sum, it seems that Rule 403 provides all the necessary tools to impeach machine output, as all the methods that are applicable to machines would be the ones currently governed by Rule 403. Moreover, it is not ideal to place the rules on impeaching machines in Article 8 as the whole point is that the hearsay rule is not directed to machine-based evidence, because you can't cross-examine a machine.

3. Rule 901(b)(9). Professor Roth suggests adding standards to the basic authentication rule for machine-based evidence.

(9) Evidence About a Process or System. Evidence describing a process or system and showing that it produces a ~~an accurate~~ reliable result, including, with the exception of basic scientific instruments, all of the following:

(A) that the opponent had fair pretrial access to the process or system;

(B) in a criminal case, the proponent has disclosed all previous output of the process or system that, if the process or system were a human witness, would be disclosable under 18 U.S.C. §3500;

(C) that the process or system has been shown through testing by a financially and otherwise independent entity to produce an accurate result under conditions substantially similar to the instant case;

(D) that the process or system, or a license to use it, is accessible to independent research bodies, including the National Institute of Standards and Technology and accredited educational institutions, for purposes of conducting audits of the process or system;

(E) that the process or system is either open source or the proprietor has given the National Institute of Standards and Technology access to its source code;

(F) that, in a criminal case, the proponent has not invoked a trade secrets privilege to block access or disclosure to the process or system or its source code.

Reporter's Comments:

1. If Rule 702 is applied to machine learning evidence, the admissibility factors will have to be shown by a preponderance of the evidence. If that happens, it should make it unnecessary to add the same or similar standards at the authenticity level, which is governed by the Rule 104(b) standard. It should be noted that Professor Roth is not necessarily suggesting changes to Rule 901(b)(9) *in addition to* Rule 702 --- rather that if Article 7 changes somehow don't work out, changes to Rule 901(b)(9) could be usefully considered. In other words, if changes are made to require a *Daubert*-like review of machine data, *then there is no need to add anything to Rule 901(b)(9)* to cover machine learning evidence.

2. Several of the requirements are about accessibility --- e.g., the provisions on trade secrets, pretrial access, and the Jencks Act alternative. As discussed above, such disclosure requirements are probably within the jurisdiction of the Criminal and Civil Rules Committees, not the Evidence Rules Committee. If anything is done about source codes in the Evidence Rules, it should probably be by way of a suggestion in a Committee Note, as was done in the Committee Note to the 2000 amendment to Rule 701 (providing that the Rule needed to be amended to assure that the expert disclosure requirements in the Civil and Criminal Rules would not be evaded). Moreover, in terms of the politics of rulemaking, these disclosure obligations are likely to be a flashpoint. It would be unfortunate if a good rule faltered because of controversy over a disclosure requirement.

3. Rule-drafting concerns exist with respect to two provisions. Subdivision (B) includes the citation to the Jencks Act. But proper rulemaking does not include citations in text --- for fear that the citation will change and then the rule would need to be amended. So if that provision were to be approved, it should say something like “under federal statute” and then the Committee Note could refer to the Jencks Act. *See* the 1998 amendment to Rule 615, adding “by statute” to the text, and referring to a specific statute in the Note. Another rule-drafting concern is the reference to NIST. A more general reference would be preferable.

C. Proposal Giving the Trial Court the Sole Responsibility to Review Deepfake Challenges

Professor Rebecca Delfino argues that the danger of deepfakes demands that the judge decide authenticity, not the jury.[8] She contends that “[c]ountering juror skepticism and doubt over the authenticity of audiovisual images in the era of fake news and deepfakes calls for reallocating the factfinding authority to determine the authenticity of audiovisual evidence.” She contends that jurors cannot be trusted to fairly analyze whether a video is a deepfake, because deepfakes appear to be authentic, and “seeing is believing.” Professor Delfino suggests that Rule 901 should be amended to add a new subdivision (c), which would provide:

> **901(c). Notwithstanding subdivision (a), to satisfy the requirement of authenticating or identifying an item of audiovisual evidence, the proponent must produce evidence that the item is what the proponent claims it is in accordance with subdivision (b). The court must decide any question about whether the evidence is admissible.**

She explains that the new Rule 901(c) “would relocate the authenticity of digital audiovisual evidence from Rule 104(b) to the category of relevancy in Rule 104(a)” and would “expand the gatekeeping function of the court by assigning the responsibility of deciding authenticity issues solely to the judge.”

The proposed rule would operate as follows: After the pretrial hearing to determine the authenticity of the evidence, if the court finds that the item is more likely than not authentic, the court admits the evidence. The court would instruct the jury that it *must accept as authentic* the evidence that the court has determined is authentic. The court would also instruct the jury not to

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[8] Rebecca Delfino, *Deepfakes on Trial: A Call to Expand the Trial Judge’s Gatekeeping Role to Protect Legal Proceedings from Technological Fakery,* 74 Hastings L.J. 293 (2023).

doubt the authenticity, simply because of the existence of deepfakes. This new rule would take the jury out of the business of determining authenticity, “thereby avoiding the problems invited by juror distrust and doubt.” (Her concern is about the “liar’s dividend” --- that juries will mistrust even authentic items given the prevalence of deepfakes.) Finally, “the court would address the threat of counsel exploiting juror doubts over the authenticity of evidence using the deepfake defense by ordering counsel not to make such arguments.”

Reporter’s Comment:

The Delfino proposal applies to *all* audiovisual evidence --- including the video evidence that courts have been dealing with for more than 100 years. Query whether the threat of deepfakes warrants such a dramatic change with respect to all video (and audio) evidence. Assuming that any amendment is necessary, the better remedy is to set out procedures, and higher standards, *only after the opponent specifically brings a credible deepfake argument.* That is what is done in the Grimm-Grossman proposal.

Another concern is about how the jury will react when it is instructed to presume authenticity. Given the presence of deepfakes in society, it may well be that jurors will do their own assessment, regardless of the instruction --- and under this proposal, that juror assessment will be done without the foundation for authenticity laid by the proponent in the admissibility hearing. It could become especially confusing when the jury is told that authenticity is a question primarily for jurors when it comes to telephone calls, diaries, and physical evidence, but when it comes to videos and audios --- hands off.

One can argue that the Delfino proposal could be improved by applying the Rule 104(a) standard to the authenticity of visual and audio evidence, but then, if the court finds authenticity, allow the jury to make its own assessment. In other words, to treat the authenticity of visual evidence the same way we treat expert testimony. Delfino would object, though, due to her belief that jurors will not be able to assess the genuineness of the evidence, given that deepfakes are getting harder and harder to detect. But this half-proposal would at least address arguments that deepfakes will be too easily admitted under the mild standard that now exists for showing authenticity to the court, and it would not set up artificial constructs to try to keep the jury from assessing authenticity.

One broader concern that is spurred by the Delfino proposal: Some of the AI apocalypse believers maintain that at some point deepfakes will be *impossible* to detect. If that is so, then it would seem that no rule of authenticity can do an adequate job of regulating deepfakes. Giving all the authority to the judge seems quite empty if *nobody* can detect a deepfake. Indeed *no rule can provide a solution if deepfakes are undetectable.*

One final point on the Delfino proposal. Delfino’s idea is that the court is to use the Rule 104(a) standard --- a preponderance of the evidence. Assuming that is appropriate, it should be added to the text of the rule. That is a lesson learned by the Committee in the amendment to Rule 702. This means that the last sentence of the proposal should read something like:

> "The court must decide whether it is more likely than not that the item is authentic."

Such an explication is especially important because the proposal does not actually explicitly say that admissibility is governed by Rule 104(a). It states that "the proponent must produce evidence that the item is what the proponent claims it is in accordance with subdivision (b)." But the illustrations of subdivision (b) are, as discussed above, decided on the less rigorous, prima facie proof standard of Rule 104(b).

The Delfino proposal is usefully compared to the Reporter's proposed modification of the Grimm-Grossman proposal discussed above. The Reporter's proposal would read as follows:

If a party challenging the authenticity of computer-generated or other electronic evidence demonstrates to the court that a jury reasonably could find that the evidence has been altered or fabricated, in whole or in part, by artificial intelligence [by an automated system], the evidence is admissible only if the proponent demonstrates to the court that it is more likely than not authentic.

The differences between the two proposals are: 1. The Delfino proposal applies the preponderance of the evidence standard to every item of audiovisual evidence, whereas the above proposal applies that higher standard only when there has been a prima facie showing of fakery; and 2) The Delfino proposal takes the authenticity question completely away from the jury, whereas the above proposal does not. It seems that the above proposal gets the better of both of these differences.

D. The Proposal to Add a Corroboration Requirement for Possible Deepfakes

John Lamonica argues for a more stringent standard of authenticity with respect to deepfakes.[9] He contends that the traditional means of authentication --- by a person with knowledge under Rule 901(b)(1) --- will no longer work with deepfakes because a witness cannot reliably testify that the video accurately represents reality. He states that "[b]ecause witnesses will no longer be able to meet the legacy standard of Rule 901(b)(1)'s knowledgeable witness by attesting that a video is a fair and accurate portrayal, courts need to look elsewhere for a sufficient finding that photographic evidence is what its proponent claims it is." He argues for a proposed new Rule 901(b)(11) that would specifically govern "the unique challenges that digital photography in the modern age present."

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[9] John P. Lamonaca, *A Break from Reality: Modernizing Authentication Standards for Digital Video Evidence in the Era of Deepfakes,* 69 Am. U.L. Rev. 1945, 1984 (2020).

The new Rule 901(b)(11) would provide:

Before a court admits photographic evidence under this rule, a party may request a hearing requiring the proponent to corroborate the source of information by additional sources.

Lamonaca explains that the new rule "essentially codifies an existing means of authentication and requires it for photographic evidence." There is no proposal to change the existing allocation of authority between the court and the jury. Rather, what it essentially does is 1) change the "distinctive characteristics" ground of Rule 901(b)(4) into a foundation *requirement*; and 2) state that the classic ground of authentication under Rule 901(b)(1) --- that the video accurately represents what it purports to show --- is never a sufficient ground of admissibility. Lamonaca concludes that "a preliminary hearing process [requiring corroboration] would bolster the confidence in video evidence for a jury to consider, rather than allowing all photographic evidence to pass the foundational stage with a testimonial witness who lacks the requisite personal knowledge to attest to the evidence's validity."

This is an interesting proposal, in that one of the major ways that deepfakes can be *debunked* is actual evidence casting doubt on what is portrayed --- e.g., "the video shows me at the bank but I was in the hospital that day." So it might not be asking too much for a proponent to provide some corroboration of the event --- but only *if there is a legitimate question of authenticity*, and the Lamonica proposal does not require that. So a major problem is that, like the Delfino proposal, it applies to *all* visual evidence, including video evidence that has been well-handled by the courts for 100 years. It seems unwarranted to require the proponent to go to the expense of providing corroboration for every surveillance video and every wedding photograph, simply because of the potential risk of deepfakes. Courts have not required an advance showing of corroboration for digital evidence, and while deepfakes present new challenges, the case has not been made as yet to justify an automatic corroboration requirement for all audio visual evidence.

The better solution is that the court should enter a deepfake inquiry only when the opponent provides some evidence indicating the possibility of a deepfake: either some electronic analysis or a showing through evidence that the event presented is implausible. And then, at that point, the proponent might be required to provide corroboration or some other additional showing before the court can find it authentic. That solution is essentially the modification to the Grimm Grossman proposal, discussed above. That solution is essentially employed today with regard to electronic evidence --- the "it is hacked" claim is not treated seriously until the opponent comes up with something to indicate that an inquiry is warranted.[10] And that solution --- placing the burden of

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[10] *See* Grimm, *et al*., *Authentication of Social Media Evidence*, 36 Am. J. of Trial Advoc. 433, 459 (2013) ("A trial judge should admit the evidence if there is plausible evidence of authenticity produced by the proponent of the evidence and only speculation or conjecture—not facts—by the opponent of the evidence about how, or by whom, it 'might' have been created.").

going forward on the opponent --- is what was employed in one of the few court cases that have discussed the deepfake possibility. The Colorado state appeals court in *People v. Gonzales*, 2019 COA 30, ¶ 29 opined that while software has made it easy for laypeople to manipulate recordings, "the fact that the falsification of electronic recordings is always possible does not, in our view, justify restrictive rules of authentication that must be applied in every case *when there is no colorable claim of alteration*."[11] The court explained that "[w]hen a plausible claim of falsification is made by a party opposing the introduction of a recording, the court may and usually should apply additional scrutiny" to determine whether a reasonable jury could conclude that the item is what it purports to be.

Three more rulemaking points about the Lamonica proposal:

1. It should not be placed as a new Rule 901(b)(11). Rule 901(b) provides examples of authenticated items. This new provision is requiring an extra admissibility requirement for evidence that will be offered under an existing provision --- such as 901(b)(9). It is not a new example of authentication. So it is better placed as separate subdivision, such as Rule 901(c), as is the Grimm-Grossman proposal.

2. The proposed rule refers to "photographic" evidence, which seems too narrow to cover all deepfakes. A term such as "audiovisual" is preferable. The Grimm-Grossman proposal simply ties into Rule 901(b)(9) --- items resulting from a process or system, which is probably the best tie-in to deepfakes.

3. The proposal as written is not actually a rule of admissibility. All it specifically requires is a hearing. So it should probably read as follows:

Before a court admits photographic evidence under this rule, ~~a party may request a hearing requiring~~ the proponent must ~~to~~ corroborate the source of information by additional sources.

In essence, a solution that requires a foundation from the opponent and then a showing by the proponent is what has been discussed above at several points:

If a party challenging the authenticity of computer-generated or other electronic evidence demonstrates to the court that a jury reasonably could find that the evidence has been altered or fabricated, in whole or in part, by artificial intelligence [by an automated system], the evidence is admissible only if the proponent demonstrates to the court that it is more likely than not authentic.

This proposal differs from a corroboration requirement in this sense: it is more flexible, because the proponent can establish authenticity in any way, not just by corroboration. As such,

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[11] *See also* Shannon Bond, *People Are Trying To Claim Real Videos Are Deepfakes. The Courts Are Not Amused,* https://www.npr.org/2023/05/08/1174132413/people-are-trying-to-claim-real-videos-are-deepfakes-the-courts-are-not-amused (noting that courts in the January 6 prosecutions have rejected out of hand broad, unsupported claims that videos could be deepfakes).

the above proposal seems to be a better approach. It also, importantly, requires a preliminary showing, which the Lamonica proposal does not.

III. The Problem of Deepfakes

A deepfake is an inauthentic audiovisual presentation prepared by software programs using artificial intelligence. Of course, photos and videos have always been subject to forgery, but developments in AI make deepfakes much more difficult to detect.[12] Software for creating deepfakes is already freely available online and fairly easy for anyone to use.[13] As the software's usability and the videos' apparent genuineness keep improving over time, it will become harder for computer systems, much less lay jurors and judges, to tell real from fake.[14]

Generally speaking, there is an arms race between deepfake technology and the technology that can be employed to detect deepfakes. Deepfakes involve machine learning algorithms that are simultaneously pitted against one another.[15] One of these programs is a generative model that creates new data samples; the other, known as a discriminator model, evaluates this data against a

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[12] Robert Chesney & Danielle Keats Citron, *Deep Fakes: A Looming Challenge for Privacy, Democracy, and National Security,* 107 Calif. L. Rev. 1753, 1760 (2019). Some of the famous deepfakes are pretty easy to root out with minimal inquiry. The Nancy Pelosi video was debunked simply by playing it slower. The Pope picture, upon scrutiny, shows up as a fake because his medal is not sitting on his chest, and his fingers are not accurate. But it is very likely that future developments will make deepfakes harder to detect.

[13] *See 12 Best Deepfake Apps and Websites That You Can Try for Fun,* https://beebom.com/best-deepfake-apps-websites.

[14] MIT has provided a checklist that can be used to help detect a deepfake, though MIT makes no promises:

> When it comes to AI-manipulated media, there's no single tell-tale sign of how to spot a fake. Nonetheless, there are several DeepFake artifacts that you can be on the lookout for:
>
> 1. Pay attention to the face. High-end DeepFake manipulations are almost always facial transformations.
> 2. Pay attention to the cheeks and forehead. Does the skin appear too smooth or too wrinkly? Is the agedness of the skin similar to the agedness of the hair and eyes? DeepFakes may be incongruent on some dimensions.
> 3. Pay attention to the eyes and eyebrows. Do shadows appear in places that you would expect? DeepFakes may fail to fully represent the natural physics of a scene.
> 4. Pay attention to the glasses. Is there any glare? Is there too much glare? Does the angle of the glare change when the person moves? Once again, DeepFakes may fail to fully represent the natural physics of lighting.
> 5. Pay attention to the facial hair or lack thereof. Does this facial hair look real? DeepFakes might add or remove a mustache, sideburns, or beard. But, DeepFakes may fail to make facial hair transformations fully natural.
> 6. Pay attention to facial moles. Does the mole look real?
> 7. Pay attention to blinking. Does the person blink enough or too much?
> 8. Pay attention to the lip movements. Some deepfakes are based on lip syncing. Do the lip movements look natural?

https://www.media.mit.edu/projects/detect-fakes/overview/

[15] Chris Nicholson, *A Beginner's Guide to Generative Adversarial Networks (GANs),* PATHMIND, https://pathmind.com/wiki/generative-adversarial-network-gan [https://perma.cc/JEY9-K283].

training dataset for authenticity. The discriminator model estimates the probability that the sample came from the generative model (a machine creation) or sample data (a real-world original). These two models operate in a cyclical fashion and learn from each other. The generative model program is learning to create false data, and the discriminator model is learning to identify whether the data is artificial. The generative model constantly improves its ability to create data sets that have a lower probability of failing the detection algorithm as the discriminator model learns to keep up, a process that continuously improves the apparent genuineness of the creation. So anytime new software is developed to detect fakes, deepfake creators can use that to their advantage in their discriminator models. A New York Times reporter reviewed some of the currently available programs that try to detect deepfakes. The programs varied in accuracy. None was accurate 100% of the time.[16]

It is important to note that various digital tools have been introduced for authenticating video recordings that a party has prepared. These tools allow the proffering party to vouch for video recordings' authenticity through an electronic seal of approval. [17] While the use of such methods increases the costs of litigation, they do appear, generally, to answer most "deepfake" claims from the opponent. While watermarks can be evaded, Professor Hany Farid states that the use of watermarks together with an identifying fingerprint is an effective way to combat the threat of deepfakes.[18] The limitation on the software is that the electronic stamp of genuineness occurs

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[16] *See How Easy Is it to Fool A.I. Detection Tools?* https://www.nytimes.com/interactive/2023/06/28/technology/ai-detection-midjourney-stable-diffusion-dalle.html?smid=nytcore-ios-share&referringSource=articleShare. *See also Another Side of the A.I. Boom: Detecting What A.I. Makes*, https://www.nytimes.com/2023/05/18/technology/ai-chat-gpt-detection-tools.html ("Detection tools inherently lag behind the generative technology they are trying to detect. By the time a defense system is able to recognize the work of a new chatbot or image generator, like Google Bard or Midjourney, developers are already coming up with a new iteration that can evade that defense. The situation has been described as an arms race or a virus-antivirus relationship where one begets the other, over and over.").

[17] *Ticks or It Didn't Happen: Confronting Key Dilemmas in Authenticity Infrastructure for Multimedia*, at 6, WITNESS (December 2019), https://lab.witness.org/ticks-or-it-didnthappen/ ("The idea is that if you cannot detect deepfakes, you can, instead, authenticate images, videos and audio recordings at their moment of capture."); Riana Pfefferkorn, *Deepfakes in the Courtroom,* 29 Public Interest L.J. 245, 259 (2020) ("So-called verified media capture technology can help to ensure that the evidence users are recording is trusted and admissible to courts of law. For example, an app called eyeWitness to Atrocities allows photos and videos to be captured with information that can firstly verify when and where the footage was taken, and can secondly confirm that the footage was not altered, all while the company's transmission protocols and secure server system create a chain of custody that allows this information to be presented in court. That information, paired with the app-maker's willingness to provide a certification to the court or send a witness to testify if needed, could satisfy a court that the video is admissible, even if the videographer is unavailable.").

[18] *See* Hany Farid, *Artificial Intelligence: A Primer for Legal Practitioner*s at 17 ("Therefore, in addition to embedding watermarks, a creator can extract an identifying fingerprint from the content and store it in a secure centralized ledger. . . . The provenance of a piece of content can then be determined by comparing the fingerprint of any image or video to the fingerprint stored in the ledger. Both watermarks and fingerprints can be made cryptographically secure, making it difficult to forge.").

during the process in which the video is being generated; it does not work with videos, say, taken off the internet.[19]

Besides the challenge of determining whether a video or audio is faked, many commentators are concerned about a "reverse CSI effect." Jurors, knowing about deepfakes, "fake news," etc., may start expecting the proponent of a video to use sophisticated technology to prove to their satisfaction that the video is not fake.[20] The other concern expressed is that over time, skepticism over video evidence may undermine the use of perfectly authentic videos --- called "the Liar's Dividend" --- though how that concern is to be addressed in an Evidence Rule remains a mystery.

A. Basic Rules on Authenticity

Under Rule 901(a), the standards for authenticity are low. The proponent must only "produce evidence sufficient to support a finding that the item is what the proponent claims it is." Under the rule, the question of authenticity is one of conditional relevance --- an item of evidence is not relevant unless it is what the proponent purports it to be. (For example, a sexually harassing statement in an email, purportedly sent from the plaintiff's supervisor, is probative only if it is the supervisor who sent it.) As a question of conditional relevance, the admissibility standard under Rule 901 is the same as that provided by Rule 104(b): Has the proponent offered a foundation from which the jury could reasonably find that the evidence is what the proponent says it is. This is a mild standard --- favorable to admitting the evidence. The drafters of the rule believed that authenticity should generally be a jury question because, if a juror finds the item to be inauthentic, it just drops from the case, so no real damage is done; Rule 901 basically operates to prevent the jury from wasting its time evaluating an item of evidence that clearly is not what the proponent claims it to be.

The structure of the Rule is as follows: 1) subdivision (a) sets the general standard for authenticity --- enough admissible evidence for a juror to believe that the proffered item is what the proponent says it is; 2) subdivision (b) provides examples of sufficient authentication; if the standard set forth in any of the illustrations is met, then the authenticity objection is overruled and any further question of authenticity is for the jury; and 3) the illustrations are not intended to be independent of each other, so a proponent can establish authenticity through a single factor or combination of factors in any particular case. Finally, it should be noted that Rule 902 provides

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[19] *See, e.g.*, *A New Tool Protects Videos from Deepfakes and Tampering,* https://www.wired.com/story/amber-authenticate-video-validation-blockchain-tampering-deepfakes/ ("Called Amber Authenticate, the tool is meant to run in the background on a device as it captures video. At regular, user-determined intervals, the platform generates 'hashes'—cryptographically scrambled representations of the data—that then get indelibly recorded on a public blockchain. If you run that same snippet of video footage through the algorithm again, the hashes will be different if anything has changed in the file's audio or video data—tipping you off to possible manipulation.").

[20] Rebecca Delfino, *Deepfakes on Trial: A Call to Expand the Trial Judge's Gatekeeping Role to Protect Legal Proceedings from Technological Fakery,* 74 Hastings L.J. 293 (2023).

certain situations in which the proffered item will be considered self-authenticating --- no reference of any Rule 901(b) illustration need be made or satisfied if the item is self-authenticating.

In order for the trier of fact to make a rational decision as to authenticity, the foundation evidence must itself be admissible. If the opponent still contests authenticity at trial, the proponent will need to present admissible evidence of the authenticity of the challenged item. This means that the judge's role when an authentication issue arises differs from the judge's role when other issues arise involving the admissibility of evidence at a Rule 104(a) hearing (under which the rules of evidence other than privilege are inapplicable). When authentication evidence is offered, a jury must be provided sufficient admissible evidence for it to find that it is what the proponent claims, or the requirement of authentication is not satisfied. A judgment as to whether a reasonable jury will find evidence to be authentic can only be made by examining the evidence that the jury will be permitted to hear.[21]

Applying the current authentication rules to deepfakes raises at least two concerns: 1. Because deepfakes are hard to detect, many deepfakes will probably satisfy the low standards of authenticity; and 2. On the other hand, the prevalence of deep fakes will lead to blanket claims of forgery, requiring courts to have an authenticity hearing for virtually every proffered video.

B. Prior Committee Decision on Special Authentication Rules for Electronic Evidence.

The rise of deepfakes is not the only technological advancement that has challenged the existing rules on authentication. In 2014, the Advisory Committee undertook a project to consider whether rules should be added to Article 9 to address digital communications and social media postings. The proposal considered was to have special rules on authenticating emails, texts, social media postings, and so forth. After significant discussion, the Committee decided not to proceed with the project. According to the Minutes of the Fall 2014 meeting, the reasons for rejection were as follows:

1. The current rules are flexible enough to handle questions about the authenticity of digital communications. For digital evidence, the most useful authentication rules within Rule 901(b) are: 901(b)(1) (a witness with personal knowledge that the evidence is what it purports to be); 901(b)(3) (comparison of the evidence with an authenticated specimen by an expert witness or the finder of fact); 901(b)(4) (the appearance, contents, substance, internal patterns or other distinctive characteristics of the item, taken together with all the circumstances); 901(b)(5) (for audio recordings, an opinion identifying a person's voice, whether heard firsthand or through electronic transmission or recording, based on having heard that voice in the past); and 901(b)(9) (evidence

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[21] *See United States v. Bonds*, 608 F.3d 495 (9th Cir. 2010) (records could not be authenticated where the only basis for authentication was a hearsay statement not admissible under any exception); *Lorraine v. Markel Am. Ins.*, 241 F.R.D. 534, 537 (D. Md. 2007) ("Because, under Rule 104(b), the jury, and not the court, makes the factual findings that determine admissibility, the facts introduced must be admissible under the rules of evidence.").

describing a process or system of showing that it produces an accurate result). These rules give the court all the tools it needs to determine the authenticity of digital evidence.

2. Any rules directed specifically toward digital communications would likely overlap with the provisions already in Rule 901(b). Certainly distinctive characteristics would be important for authenticating digital evidence; and authentication of, say, email would use analogous principles of authenticating telephone conversations. This overlap, between new and old rules, would likely cause confusion.

3. Listing factors relevant to authentication would run the risk of misleading courts and litigators into thinking that all of the listed factors can or should be weighed equally, when in fact a case-by-case approach is required.

4. Given the deliberateness of rulemaking --- three years minimum --- there was a risk that any rule on digital communications could be dead on arrival. I called it the MySpace problem.[22]

In hindsight, it is fair to state that the Committee's decision to forego amendments setting forth specific grounds for authenticating digital evidence was the prudent course. Courts have sensibly, and without extraordinary difficulty, applied the grounds of Rule 901 to determine the authenticity of digital evidence.[23] Courts have specifically rejected blanket claims like "my account was hacked" --- because such an argument can always be made. Courts properly require some showing from the opponent before inquiring into charges of hacking and falsification of digital information. Thus, courts have consistently held that "the mere allegation of fabrication

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[22] It should be noted that the Committee did propose two new rules to deal with authenticating digital evidence --- Rules 902(13) and (14), which became effective in 2017. But these rules do not add or change any grounds of authentication for digital evidence. Rather they allow the existing grounds to be established by a certificate of a person with knowledge, thus dispensing with the requirement of in-court testimony.

[23] *See, e.g.*, *United States v. Fluker*, 698 F.3d 988 (7th Cir. 2012) (the court, in outlining the variety of ways in which an email could be authenticated, stated that testimony from a witness who purports to have seen the declarant create the email in question was sufficient for authenticity under Rule 901(b)(1)); *United States v. Barnes*, 803 F.3d 209 (5th Cir. 2015) (government laid a proper foundation to authenticate Facebook and text messages as having been sent by the defendant; the defendant was a quadriplegic, but the witness who received the messages testified she had seen the defendant use Facebook, she recognized his Facebook account, and the Facebook messages matched the defendant's manner of communicating: "[a]lthough she was not certain that Hall [the defendant] authored the messages, conclusive proof of authenticity is not required for admission of disputed evidence"); *United States v. Lundy*, 676 F.3d 444 (5th Cir. 2012) (testimony by one party to chat that the chats are as he recorded them is enough to meet the low threshold for authentication); *United States v. Needham*, 852 F.3d 830, 836 (8th Cir. 2017) ("Exhibits depicting online content may be authenticated by a person's testimony that he is familiar with the online content and that the exhibits are in the same format as the online content. Such testimony is sufficient to provide a rational basis for the claim that the exhibits properly represent the online content. . . [The witness] testified that he personally viewed the [webpages] and that the screenshots accurately represented the online content of both sites. Thus, the district court did not abuse its discretion by admitting the screenshots."); *United States v. Recio*, 884 F.3d 230 (4th Cir. 2018) (the government sufficiently tied the "Facebook User" to the defendant by showing that: (1) the user name associated with the account was Larry Recio; (2) one of the four email addresses associated with the account was larryrecio20@yahoo.com; (3) more than 100 photos of Recio were posted to the account, and (4) one of the photos posted to the user timeline was accompanied by the text "Happy Birthday Larry Recio").

does not and cannot be the basis for excluding ESI as unauthenticated as a matter of course, any more than it can be the rationale for excluding paper documents."[24]

It is true that litigators have to know what they are doing when they try to authenticate digital evidence, and it is also true that authenticating digital evidence can be costly, but no rule of evidence would change that.[25] Moreover, some costs of proving authenticity can be saved by the affidavit procedures established for authentication of digital evidence in Rules 902(13) and (14).[26]

The fact that the Committee decided not to promulgate special rules on digital communication is a relevant data point, but it is not necessarily dispositive of amending the rules to treat deepfakes.[27] While a special rule setting forth the grounds for possible authentication of audiovisual evidence runs a similar risk of overlap, perhaps a rule of procedure (such as the requirement of a special showing made to the court), or a higher standard of proof, could be useful. And a rule may be necessary because deepfakes may present a true watershed moment and might require a new approach.

C. Arguments Against an Amendment for Deepfakes

Not all commentators believe that a change to the rules is necessary for dealing with deepfakes. Riana Pfefferkorn notes that the courts have previously handled technological changes under the existing rules, and deepfakes can be handled in the same way.[28] She asserts that the courts are "no stranger to doctored photographs" and that "generations of technologies with truth-subversive potential have become commonplace in society over the years. While the resulting fakes have inevitably gained traction at times in the public consciousness, the sky has not fallen." She states that "[t]he existence of the mere possibility of manipulation, without more, does not call for a high bar of authentication today any more than it did 150 years ago." She concludes that "the nation's courts are robust institutions that have shown themselves capable of handling each new variant of the age-old problem of fakery" and that the courts' "track record of resilience should

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[24] *United States v. Safavian*, 435 F. Supp. 2d 36, 38 (D.D.C. 2006).

[25] *See* Jeffrey Bellin and Andrew Guthrie Ferguson, *Judicial Notice in the Information Age,* 108 Nw. U.L. Rev. 1137, 1157 (2014) ("Although much is made of [the authentication] hurdle in the Information Age, it is … an easy one to surmount. Success generally depends not on legal or factual arguments, but rather the amount of time and resources a litigant devotes to the problem.").

[26] Tara Vassefi, "*A Law You''ve Never Heard of Could Help Protect Us From Deceptive Photos and Videos,"* UC Berkeley School of Law Human Rights Center (Nov. 30, 2018), https://medium.com/humanrightscenter/a-law-youve-never-heard-of-could-help-protect-usfrom-fake-photos-and-videos-df07119aaeec (noting that Rules 902(13 and (14) "streamlin[e] authentication for those with limited legal resources").

[27] For one thing, it is not stare decisis. The Committee has proposed amendments to rules that it rejected in the first instance. The amendments to Rule 106 and new Rule 107 are just two examples. Also, perhaps the dangers of fakery are greater with respect to deepfakes than were presented by digital evidence in 2014.

[28] Riana Pfefferkorn, *Deepfakes in the Courtroom,* 29 Public Interest L.J. 245, 259 (2020).

assuage” much of the concerns about deepfakes.[29] Pfefferkorn’s view is that the rise of deepfakes will probably increase the costs of authentication, perhaps by requiring expert testimony in more cases than previously. But that does not mean that the rules need to be amended.

Similarly, Grant Fredericks, the president of Forensic Video Solutions and a pioneer in the field of deepfake technology, is confident that fake videos will be kept out of evidence, both because they can be discovered using the advanced tools of his trade and because the video’s proponent would be unable to answer basic questions to authenticate it (who created the video, when, and with what technology).[30]

Finally, Professor Rebecca Wexler, in her presentation to the Committee last Fall, made a compelling presentation arguing that the courts have extensive experience with forgeries, and that no special rule is needed to deal with deepfakes.

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[29] *See also* Russell Brandom, Deepfake Propaganda is not a Real Problem, THE VERGE (Mar. 15, 2019), https://www.theverge.com/2019/3/5/18251736/deepfake-propaganda-misinformation -troll-video-hoax (“We’ve had the tools to fabricate videos and photos for a long time. . . . AI tools can make that process easier and more accessible, but it’s easy and accessible already. . . . [D]eepfakes are already in reach for anyone who wants to cause trouble on the internet. It’s not that the tech isn’t ready yet. It just isn’t useful.”); Jeffrey Westling, *Deep Fakes: Let’s Not Go Off the Deep End*, TECHDIRT (Jan. 30, 2019), https://www.techdirt.com/articles/20190128/13215341478/deep-fakes-lets-not-gooff-deep-end.shtml.

[30] Mark J. Pescatore, *Forensic Video Experts: Fake Videos Not Threat to Courtroom Evidence*, PIPELINE COMM. (June 24, 2019), https://www.pipecomm.com/2019/06/24/forensic-video-experts-fake-videos-not-threat-to-courtroom-evidence/.

IV. Conclusion and Drafting Alternatives

This memo has covered a number of possible changes to address deepfakes and machine learning. Assuming, again, that any change is necessary, the most straightforward and effective changes are the following:

1. *Changes to Rule 901(b):* [ASSUMING NO ADDITION OF RULE 707]

[901](b) **Examples**. The following are examples only—not a complete list—of evidence that satisfies the requirement [of Rule 901(a)]:

(9) *Evidence about a Process or System*. For an item generated by a process or system:

(A) evidence describing it and showing that it produces ~~an accurate~~ **a reliable** result; and

(B) if the proponent acknowledges that the item was generated by artificial intelligence, additional evidence that:

(i) describes the training data and software or program that was used; and

(ii) shows that they produced reliable results in this instance.

2. Proposed New Rule 901(c) to address "Deepfakes":

901(c): *Potentially Fabricated or Altered Evidence Created By Artificial Intelligence [By an Automated System].*

If a party challenging the authenticity of computer-generated or other electronic evidence demonstrates to the court that a jury reasonably could find that the evidence has been altered or fabricated, in whole or in part, by artificial intelligence [by an automated system], the evidence is admissible only if the proponent demonstrates to the court that it is more likely than not authentic.

Draft Committee Note

This new subdivision is intended to set forth guidance and standards when the opponent alleges that an audio or video item is a "deepfake" --- i.e., that it has been altered by artificial intelligence so that it is not what the proponent says it is.

The term "artificial intelligence" can have several meanings, and it is not a static term. In this rule, "artificial intelligence" means software used to perform tasks or produce output previously thought to require human intelligence.

The rule sets out a two-step process for regulating claims of deepfakes. First, the opponent must set forth enough information for a reasonable person to find that the item has been altered by the use of artificial intelligence. Thus, a broad claim of "deepfake" is not enough to put the court and the proponent to the time and expense of showing that the item has not been manipulated by artificial intelligence. Second, assuming that the opponent has shown enough to merit the enquiry, the proponent must show to the court that the item is more likely than not genuine. While that Rule 104(a) standard is higher than ordinarily required for a showing of authenticity, it is justified given that any member of the public has the capacity to make a deepfake, with little effort and expense, and deepfakes have become more difficult to detect. It is therefore reasonable for the court to require a showing, by a preponderance of the evidence, that the item is not a deepfake, once the opponent has met its burden of going forward.

3. New Rule 707

Rule 707. Machine-generated Evidence

Where the output of a process or system would be subject to Rule 702 if testified to by a human witness, the court must find that the output satisfies the requirements of Rule 702 (a)-(d). This rule does not apply to the output of basic scientific instruments or routinely relied upon commercial software.

Draft Committee Note

Expert testimony in modern trials increasingly relies on software- or other machine-based conveyances of information, from software-driven blood-alcohol concentration results to probabilistic genotyping software. Machine-generated evidence can involve the use of a computer-based process or system to make predictions or draw inferences from existing data. When a machine draws inferences and makes predictions, there are concerns about the reliability of that process, akin to the reliability concerns about expert witnesses. Problems include using the process for purposes that were not intended (function creep); analytical error or incompleteness; inaccuracy or bias built into the underlying data or formulas; and lack of interpretability of the machine's process. Where an expert relies on such a method, the method – and the expert's reliance on it – will be scrutinized pursuant to Rule 702. But if machine or software output is presented on its own, without the accompaniment of a human expert, Rule 702 is not obviously applicable. Yet it cannot be that a proponent can evade the reliability requirements of Rule 702 by offering machine output directly, where the output would be subject to 702 if rendered as an opinion by a human expert. Therefore, new Rule 707 provides that if machine output is offered directly, it is subject to the requirements of Rule 702 (a)-(d).

It is anticipated that a Rule 707 analysis will involve the following, where applicable:

• Considering whether the inputs into the process are sufficient for purposes of ensuring the validity of the resulting output. For example, the court should consider whether the training data for a machine learning process is sufficiently representative to render an accurate output for the population involved in the case at hand.

- [Ensuring that the opponent has been provided sufficient access to the program, and that independent researchers have had sufficient access to the program, to allow both adversarial scrutiny and sufficient peer review beyond simply validation studies conducted by the developer or related entities. Where a developer has declined to make a research license or equivalent access widely available to independent researchers, courts should be wary of allowing output from such a process.]

- Considering whether the process has been validated in circumstances sufficiently similar to the case at hand. For example, if the case at hand involves a DNA mixture of several contributors, likely related to each other, and a low quantity of DNA, the software should be shown to be valid in those circumstances before being admitted.

The final sentence of the rule is intended to give trial courts sufficient latitude to avoid unnecessary litigation over machine output that is regularly relied upon in commercial contexts outside litigation and that, as a result, is not likely to render output that is invalid for the purpose it is offered. Examples might include the results of a mercury-based thermometer, battery-operated digital thermometer, or automated averaging of data in a spreadsheet, in the absence of evidence of untrustworthiness.

The Rule 702(b) requirement of sufficient facts and data, as applied to machine-generated evidence, should focus on the information entered into the process or system that leads to the output offered into evidence.

Tab G

MEMORANDUM

To: Texas Supreme Court Advisory Committee (SCAC)

From: Rules of Evidence Subcommittee

Re: Update on Potential Rules Amendments to Address Artificial Intelligence

Date: October 28, 2024

Following the August 16, 2024, Supreme Court Advisory Committee meeting, our subcommittee has been reviewing whether the Texas Rules of Evidence should be amended to address issues related to artificial intelligence, particularly involving generative AI and the unique concerns caused by 'deep-fakes'. (Please see the Subcommittee's August memo for additional background.)

The Subcommittee has reviewed studies and law review articles discussing the advent of AI and the unique evidentiary issues that will impact the determination of authenticity, admissibility and whether the admission of this evidence could be unfairly prejudicial. Some of those articles are included in the material appended to this memo.

Deepfakes in Court How Judges Can Pro	Deepfake Dilemma Chopp edits TX Bar J	The Problem of Deepfakes and AI-Ge

The Subcommittee paid particular attention ongoing discussions by the Federal Rules of Evidence Advisory Committee that has been reviewing whether the Federal Rules of Evidence should be amended to address the unique evidentiary consequences triggered by the development of AI technology. Of note are the October 27, 2023, April 19, 2024, and November 8, 2024, Advisory Committee Agenda Books that include reports on the topic and minutes of the Advisory Committee's deliberations. The Subcommittee commends to the Committee the excerpt from November 8 Agenda Book included as an exhibit to this Memo.

The Subcommittee also met virtually with Judge Paul Grimm (former U.S. District Judge and Director of the Bolch Judicial Institute at Duke University and Professor of Law) and Professor Maura Grossman, University of Waterloo - David R. Cheriton School of Computer Science; York University - Osgoode Hall Law School, to discuss their proposals to (1) amend the Federal Rules of Evidence to address the challenge of deep-fakes and (2) amending Rule 901 to provide a specific methodology for parties to prove-up AI generated records.

The Subcommittee's Recommendation

The Subcommittee has concluded that the Advisory Committee should consider amendments to the Texas Rules of Evidence to provide trial courts and parties with guidance on resolving evidentiary issues arising out of disputes whether proffered evidence is reliable and authentic or potentially a deep fake generated by AI. Additionally, the Subcommittee also believes there is merit in the Committee considering amending Rule 901 and 902 and the Comments to the rules to provide courts and litigants with a clear procedure to address the authentication of AI generated records and how to resolve objections to admission of this evidence.

But the Subcommittee recommends that the Committee defer acting on potential amendments to the Texas Rules of Evidence to monitor the deliberations of the Federal Evidence Rules Advisory Committee which has been evaluating the same issues pertaining to AI. As reflected in the portion of the Evidence Advisory Committee's Agenda Book, the Advisory Committee will discuss potential options at its November 8, 2024, meeting in Washington, D.C.

The Subcommittee will continue to monitor the work of the Federal Rules of Evidence Advisory Committee and plans to work towards a proposed set of amendments for the Committee's consideration in early 2025.

Tab H

November 9, 2021

To: Remote Proceedings Task Force

From: Lisa Hobbs, chair, Subcommittee 1

Re: Subcommittee 1's Report and Recommendations

Subcommittee one met on the following dates:

September 29, 2021
October 12, 2021
November 3, 2021

Our proposed new and amended rules are attached as Exh. A.

Task 1: Recording and Broadcasting Rules

One of the most difficult of our subcommittee's tasks was to review and recommend amendments to the Texas rules governing the recording and broadcasting of court proceedings in light of the trend towards remote proceedings via Zoom, YouTube, etc. The subcommittee reviewed two rules. *See* TEX. R. CIV. P. 18c; TEX. R. APP. P 14 (copies of current rules attached as Exh. B).

In addition to the current rules, the subcommittee also reviewed and relied on two other documents. First, the Office of Court Administration has created a document entitled *Background and Legal Standards – Public Right to Access Remote Hearings During Covid-19 Pandemic*. (See Exh. C.)[1] Second, in the early nineties, the Texas Supreme Court studied and finalized uniform rules for the coverage of court proceedings, which served as a template for many counties who have adopted a local rule on broadcasting. *See, e.g.*, Misc. Docket No. 92-0068 (attached as Exh. D).

The subcommittee observed the differences in approaches to the various rules and standards. Most notably, current Rule 18c appears to require consent of participants before a proceeding can be recorded or broadcast. *See also In re BP Products North America Inc.*, 263 S.W.3d 117 (Tex. App.—Houston [1st Dist.] 2006, orig. proceeding)

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[1] OCA provided trial courts a wealth of information on remote proceedings during the pandemic, which can be accessed here: TJB | Court Coronavirus Information | Electronic Hearings (Zoom) (txcourts.gov)

(conditionally issuing writ of mandamus in a case where a Galveston trial court allowed the "gavel to gavel" broadcast of a trial over one party's objection). Rule 18c is alone in this approach. The other rules and guidelines, including TRAP 14, leave the decision to record or broadcast to the trial or appellate court, presumably even over an objection by a party or participant.

The variance left a lot for the subcommittee to discuss. Some discussions were more philosophical; some discussions were more practical:

- When these rules were originally drafted, they contemplated a television camera in a physical courthouse to air on an evening newscast. Technology, and thus an individual's expectation of access and to information, has increased dramatically. There is room to completely re-write the rules with those expectations and technological advances in mind.
- Any "right to access" the courthouse is not an unfettered right. Live broadcasts during the pandemic were not an entitlement; they were a practical necessity for the participants and so the judicial process did not grind to a halt. As we get back to "normal," courthouses are and will be physically opened. There is no established "right" for the public to watch a proceeding from the comfort of their own homes.
- When sensitive and protected information is presented in a courtroom, rather than in person or remotely, that information must be protected. Any new rules should address that issue (particularly the issue of trade secrets) directly.
- A definition of "remote proceeding" might be helpful. A remote proceeding is not any proceeding in which any participant is participating remotely. A remote proceeding is one in which the judge is not in the courtroom, *i.e.*, there is no physical courtroom to "open" to the public.
- What is the nature of the public's right to access? What are the parameters of that right? The current rules, though philosophically different, already adopt the basic principle that the public's right to access is not unfettered and is subject to reasonable restrictions. (*See In re M-I L.L.C.*, 505 S.W.3d 569, 577-78 (Tex. 2016) ("To the extent the open-courts provision might confer a right of public access, this right clearly would not be absolute, but instead would be subject to reasonable limitations imposed to protect countervailing interests.")). We need not start from a blank slate. We should consider the limitations and restrictions already considered in Texas in past studies.
- With the publication of proceedings on a site like YouTube, there is the potential for misuse that was less of a concern under the traditional context of a media

entity recording portions of a proceeding for news broadcast purposes. These readily available, unedited recordings may pose security risks for the participants. They are also easy to manipulate and to be used for nefarious purposes—particularly in a state like Texas that elects judges. The potential for misuse raises practical questions, *e.g.*, should there be time limits for how long footage is stored/accessible?

- Should the procedures and standards for recording or broadcasting be different whether the medium is traditional media versus a court-controlled medium (like You-Tube)? Courts that regularly livestream their docket do not want an unwieldly process that might encourage objections to what is now seen as routine. This philosophy may create tension with business litigants who prefer a more defined procedure to guide a trial court when proprietary or trade secret information is at issue in a lawsuit.
- How detailed should the rule be?
    - Should it be a broad rule, leaving the issue in the trial court's sole discretion?
    - Should it provide time limitations or broader concepts like "reasonableness"/ "opportunity to be heard"?
    - Should the rule be permissive ("may… under these limitations…") or prohibitive ("cannot . . . unless")?
    - Who has the burden? What is the showing? Should findings be required?
    - Should there be an avenue for appellate review? If so, what is the standard of review?
    - Should a local jurisdiction be able to expand or restrict access inconsistent with any new rule?
- A final concern that did not get incorporated in the draft due to time constraints: some subcommittee member would expressly state that the ruling on an objection to recording/broadcasting must be made prior to a proceeding being recorded/broadcast, whether as a matter of good procedure or so that a party would have an express ruling for mandamus purposes. Others felt the ruling would be implicit in the trial court's action to record/broadcast (or not).

Task 2: TRAP recommendations

The subcommittee also reviewed the Texas Rules of Appellate Procedure to consider whether any rules needed to be amended to account for any new rules regarding remote proceedings that are recorded or broadcast.

As a result of its review, the subcommittee proposes amendments to the Texas Rules of Appellate Procedure to (1) conform TRAP 14 with new proposed TRCP 18c; and (2) expressly authorize remote oral argument in all cases. In making these recommendations, the subcommittee reviewed the relevant provisions of Chapter 22 of the Government Code and makes a few observations.

First, the Government Code authorizes any appellate court to "order that oral argument be presented through the use of teleconferencing technology." TEX. GOV'T CODE §22.302.[2] The Government Code also authorizes the two high courts to record and post online their arguments. TEX. GOV'T CODE §22.303 ("If appropriated funds or donations are available in the amount necessary to cover the cost, the supreme court and the court of criminal appeals shall make a video recording or other electronic visual and audio recording of each oral argument and public meeting of the court and post the recording on the court's Internet website."). The Government Code does not appear to authorize livestreaming for any appellate court and, more importantly, does not appear to authorize the intermediate appellate courts to even record and post online their oral arguments. Proposed amendments to TRAP 14 expressly provide that authority for all appellate courts.

Second, generally speaking, transferred cases must be heard in the originating appellate district unless all parties agree otherwise. TEX. GOV'T CODE §73.003. Likewise, some courts of appeals must hold argument in certain cases in a specific city or county. *See* TEX. GOV'T CODE TEX. GOV'T CODE §22.204 (Third CA must hold argument in Travis County in Travis County); §22.205 (Fourth CA must hold argument in Bexar County appeals in Bexar County); §22.207 (Sixth CA must hold argument in Bowie County appeals in Texarkana); §22.209 (Eighth CA must hold argument in El Paso appeals in El Paso county); §22.213 (Twelfth CA must hold argument in Smith County appeals in Tyler); TEX. GOV'T CODE §22.214 (Thirteenth CA must hold argument in Nueces County cases in Nueces County and cases from Cameron, Hidalgo, or Willacy County shall be heard and transacted in Cameron, Hidalgo, or Willacy counties). *See also* Roger Hughes, *The Fixed Locale Requirements for Appellate Court Proceedings: The Importance of Being Somewhere if You're Not Anywhere*, 22 APP. ADVOC. 122 (Winter 2009) (discussing in greater detail "fixed locale requirements" for Texas appellate courts and their history).

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[2] There is also a specific authorization for remote proceedings in election proceedings. TEX. GOV'T CODE §22.305(b) (entitled "PRIORITY OF CERTAIN ELECTION PROCEEDINGS," and providing "[i]f granted, oral argument for a proceeding described by Subsection (a) may be given in person or through electronic means"). This is probably unnecessary given the general authorization in Section 22.302.

Even in these situations, however, it appears that appellate courts can hold argument remotely in lieu of in-person argument at a specific location. *See, e.g.*, TEX. GOV'T CODE §73.003(e) (allowing the chief justice of an appellate court to elect to "hear oral argument through the use of teleconferencing technology" in transferred cases); §22.302 (more generally authorizing an appellate "court and the parties or their attorneys [to] participate in oral argument from any location through the use of teleconferencing technology." Nevertheless, the subcommittee recommends adding a provision in proposed amendments to TRAP 39.8 to make clear that the general authority to hear a case remotely applies even when a particular case, by statute, must be heard in a particular location.

The additional notice requirements were added as good policy and to conform with existing practice.

The subcommittee recognized that having a recording of a proceeding, in addition to a transcribed record of the proceeding, may create confusion concerning the "official record" of a proceeding for purposes of appeal. The subcommittee unanimously agreed that the "official record" of a proceeding for purposes of appeal is only the transcribed record. The broadcast/recording is not the official record and should not be made a part of the appellate record. Moreover, any disputes about the "official record," whether prompted by a recording or otherwise, should be resolved by the trial court, not an appellate court. The subcommittee ultimately decided to include in proposed Rule 18c a notation about this issue. A similar provision could be added to TRAP 13.2 (duties of "official recorders").

Task 3: Rule of Judicial Administration 12

Rule of Judicial Administration 12 provides public access to "judicial records." The Rule is essentially the judiciary's version of the Public Information Act. The rule defines "judicial record" to expressly exclude records "pertaining to [a court's] adjudicative function, regardless of whether that function relates to a specific case." TEX. R. JUD. ADMIN. 12.2(d). "A record of any nature created, produced, or filed in connection with any matter that is or has been before a court is not a judicial record." *Id.* Thus, under the current version of the rule, a "Zoom" recording of a hearing or proceeding is not a "judicial record" subject to Rule 12. *See, e.g.*, Rule 12 Decision, Appeal No. 21-009 (May 24, 2021) (available online at 21-009.pdf (txcourts.gov)).

Nevertheless, courts continue to receive requests for recordings of case-specific hearings and proceedings. The subcommittee recommends amending Rule 12 to make the current law more express as it relates to recordings of court proceedings.

EXHIBIT A

New Texas Rule of Civil Procedure 18c:

Recording and Broadcasting of Court Proceedings

18c.1. Recording and Broadcasting Permitted

A trial court may permit courtroom proceedings to be recorded or broadcast in accordance with this rule and any standards adopted by the Texas Supreme Court. This rule does not apply to an investiture, or other ceremonial proceedings, which may be broadcast or recorded at the trial court's sole discretion, with or without guidance from these rules.

18c.2. Recording and Broadcasting as a Matter of Course

A trial court may record or broadcast courtroom proceedings over which the trial court presides via a court-controlled medium. If a trial court elects to broadcast the proceeding, the trial court must give reasonable notice to the parties. Reasonable notice may include posting on the trial court's official webpage a general notice stating the types of proceedings recorded and broadcasted as a matter of course and the medium of broadcasting. Parties may object to a proceeding being recorded or broadcast by following the procedures and standards set forth in this rule.

18c.3 Procedure Upon Request

(a) *Request to Cover Court Proceeding*. A person wishing to cover a court proceeding by broadcasting, recording, or otherwise disseminating the audio, video, or images of a court proceeding must file with the court clerk a request to do so. The request must state:

(A) the case style and number;
(B) the date and time when the proceeding is to begin;
(C) the name of the requesting person or organization;
(D) the type of coverage requested (for example, televising or photographing);
(E) the type and extent of equipment to be used; and
(F) that all parties were notified of the request.

(b) *Response*. Any party may file a response to the request. If a party objects to coverage of a hearing, the objections must not be conclusory and must state the specific and demonstrable injury alleged to result from coverage.

(c) *Hearing*. The requestor or any party may request a hearing on objections to broadcasting or recording a proceeding, which may be granted so long as the hearing will not substantially delay the proceeding or cause undue prejudice to any party or participant.

18c.4. Decision of the Court

In making the decision to record or broadcast court proceedings, the court may consider all relevant factors, including but not limited to:

(1) the importance of maintaining public trust and confidence in the judicial system;
(2) the importance of promoting public access to the judicial system;
(3) whether public access to the proceeding is available absent the broadcast or recording of the proceeding;
(4) the type of case involved;
(5) the importance of, and degree of public interest in, the court proceeding;
(6) whether the coverage would harm any participants;
(7) whether trade secrets or other proprietary information will be unduly disseminated;
(8) whether the coverage would interfere with the fair administration of justice, provision of a fair trial, or the rights of the parties;
(9) whether the coverage would interfere with any law enforcement activity;
(10) the objections of any of the parties, prospective witnesses, victims, or other
(11) participants in the proceeding of which coverage is sought;
(12) the physical structure of the courtroom and the likelihood that any equipment required to conduct coverage of proceedings can be installed and operated without disturbance to those proceedings or any other proceedings in the courthouse;
(13) the extent to which the coverage would be barred by law in the judicial proceeding;
(14) undue administrative or financial burden to the court or participants; and
(15) the fact that any party, prospective witness, victim, or other participant in the proceeding is a child, to which fact the court shall give great weight.[1]

18c.5 Official Record

Video or audio reproductions of a proceeding pursuant to these rules shall not be considered as part of the official court record.

18c.6 Violations of Rule

Any person who records, broadcasts, or otherwise disseminates the audio, video, or imagery of a court proceeding without approval in accordance with this rule may be subject to disciplinary action by court, up to and including contempt.

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[1] Some subcommittee members would remove the phrase "to which fact the court shall give great weight" because it may cause more confusion than clarity. This phrase comes from the factors the supreme court adopted in Misc. Docket No. 92-0068.

Proposed Revisions to Texas Rules of Appellate Procedure 14:

Rule 14. Recording and Broadcasting Court Proceedings

14.1. Recording and Broadcasting Permitted

An appellate court may permit courtroom proceedings to be broadcast, televised, recorded, or photographed in accordance with this rule.

14.2. Recording and Broadcasting as a Matter of Course

An appellate court may record or broadcast courtroom proceedings over which the court presides via a court-controlled medium upon reasonable notice to the parties. Reasonable notice may include posting a general notice on the court's official webpage. Parties may object to a proceeding being recorded or broadcast by following the procedures and standards set forth in this rule.

14.3 Procedure Upon Request

(a) *Request to Cover Court Proceeding*.

(1) A person wishing to broadcast, televise, record, or photograph a court proceeding must file with the court clerk a request to cover the proceeding. The request must state:

(A) the case style and number;
(B) the date and time when the proceeding is to begin;
(C) the name of the requesting person or organization;
(D) the type of coverage requested (for example, televising or photographing); and
(E) the type and extent of equipment to be used.

(2) A request to cover argument of a case must be filed no later than five days before the date the case is set for argument and must be served on all parties to the case. A request to cover any other proceeding must be filed no later than two days before the date when the proceeding is to begin.

(b) *Response*. Any party may file a response to the request. If the request is to cover argument, the response must be filed no later than two days before the date set for argument. If a party objects to coverage of the argument, the response should state the injury that will allegedly result from coverage.

(c) *Court May Shorten Time*. The court may, in the interest of justice, shorten the time for filing a document under this rule if no party or interested person would be unduly prejudiced.

(d) *Decision of Court*. In deciding whether to allow coverage, the court may consider information known ex parte to the court. The court may allow, deny, limit, or terminate coverage for any reason the court considers necessary or appropriate, such as protecting the parties' rights or the dignity of the court and ensuring the orderly conduct of the proceedings.

Proposed Revisions to Texas Rules of Appellate Procedure 39:

Rule 39. Oral Argument; Decision Without Argument

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39.8. Remote Argument

An appellate court may hold oral argument with participants physically present in the courtroom or remotely by audio, video, or other technological means. An oral argument held remotely complies with statutory provisions requiring argument be held in a specific location regardless of where the justices and participants are located at the time of argument.

39.9 Clerk's Notice

The clerk must send to the parties—at least 21 days before the date the case is set for argument or submission without argument—a notice telling the parties:

(a) whether the court will allow oral argument or will submit the case without argument;

(b) the date of argument or submission without argument;

(c) if argument is allowed, the time allotted for argument; ~~and~~

(d) the names of the members of the panel to which the case will be argued or submitted, subject to change by the court; and

(e) if a remote argument, whether the argument will be recorded or broadcast pursuant to Rule 14.2.

A party's failure to receive the notice does not prevent a case's argument or submission on the scheduled date.

Proposed Revisions to Texas Rules of Appellate Procedure 59:

Rule 59. Submission and Argument

59.2. Submission With Argument

If the Supreme Court decides that oral argument would aid the Court, the Court will set the case for argument. The clerk will notify all parties of the submission date, location, and, if a remote argument, whether the argument will be recorded or broadcast pursuant to Rule 14.2.

12.3 Applicability. This rule does not apply to:

(a) records or information to which access is controlled by:

- (1) a state or federal court rule, including:
  - (A) a rule of civil or criminal procedure, including Rule 76a, Texas Rules of Civil Procedure;
  - (B) a rule of appellate procedure;
  - (C) a rule of evidence;
  - (D) a rule of administration;
- (2) a state or federal court order not issued merely to thwart the purpose of this rule;
- (3) the Code of Judicial Conduct;
- (4) Chapter 552, Government Code, or another statute or provision of law;

(b) records or information to which Chapter 552, Government Code, is made inapplicable by statute, rule, or other provision of law, other than Section 552.003(1)(B);

(c) records or information relating to an arrest or search warrant or a supporting affidavit, access to which is controlled by:

- (1) a state or federal court rule, including a rule of civil or criminal procedure, appellate procedure, or evidence; or
- (2) common law, court order, judicial decision, or another provision of law

(d) elected officials other than judges~~.~~; or

(e) recordings of a remote proceeding made pursuant to Rule 18c.

EXHIBIT B

Texas Rules of Civil Procedure 18c provides:

> **Recording and Broadcasting of Court Proceedings**
>
> A trial court may permit broadcasting, televising, recording, or photographing of proceedings in the courtroom only in the following circumstances:
>
> (a) in accordance with guidelines promulgated by the Supreme Court for civil cases, or
>
> (b) when broadcasting, televising, recording, or photographing will not unduly distract participants or impair the dignity of the proceedings and the parties have consented, and consent to being depicted or recorded is obtained from each witness whose testimony will be broadcast, televised, or photographed, or
>
> (c) the broadcasting, televising, recording, or photographing of investiture, or ceremonial proceedings.

Texas Rules of Appellate Procedure 14 provides:

Rule 14. Recording and Broadcasting Court Proceedings

14.1. Recording and Broadcasting Permitted

An appellate court may permit courtroom proceedings to be broadcast, televised, recorded, or photographed in accordance with this rule.

14.2. Procedure

(a) *Request to Cover Court Proceeding.*

(1) A person wishing to broadcast, televise, record, or photograph a court proceeding must file with the court clerk a request to cover the proceeding. The request must state:

(A) the case style and number;
(B) the date and time when the proceeding is to begin;
(C) the name of the requesting person or organization;
(D) the type of coverage requested (for example, televising or photographing); and
(E) the type and extent of equipment to be used.

(2) A request to cover argument of a case must be filed no later than five days before the date the case is set for argument and must be served on all parties to the case. A request to cover any other proceeding must be filed no later than two days before the date when the proceeding is to begin.

(b) *Response*. Any party may file a response to the request. If the request is to cover argument, the response must be filed no later than two days before the date set for argument. If a party objects to coverage of the argument, the response should state the injury that will allegedly result from coverage.

(c) *Court May Shorten Time*. The court may, in the interest of justice, shorten the time for filing a document under this rule if no party or interested person would be unduly prejudiced.

(d) *Decision of Court*. In deciding whether to allow coverage, the court may consider information known ex parte to the court. The court may allow, deny, limit, or terminate coverage for any reason the court considers necessary or appropriate, such as protecting the parties' rights or the dignity of the court and ensuring the orderly conduct of the proceedings.

EXHIBIT C

BACKGROUND AND LEGAL STANDARDS – PUBLIC RIGHT TO ACCESS TO REMOTE HEARINGS DURING COVID-19 PANDEMIC[1]

On March 13, 2020, the Supreme Court of Texas and Court of Criminal Appeals issued the First Emergency Order Regarding the COVID-19 State of Disaster and authorized all courts in Texas in any case – civil or criminal – without a participant's consent to: 1) conduct any hearing or court proceeding remotely through teleconferencing, videoconferencing, or other means; and 2) conduct proceedings away from the court's usual location *with reasonable notice and access to the participants and the public*.[2] This emergency order's recognition of the public's right to reasonable notice and access to court proceedings, both civil and criminal, is consistent with traditional practice in Texas state courts and with federal and state precedent as discussed below.

The 6th Amendment of the Constitution of the United States affords defendants the right to a public trial, including all phases of criminal cases. Texas extends that right through the 14th Amendment to juvenile justice cases brought under Chapter 54 of the Texas Family Code.[3]

The Supreme Court has also held that the press and public have a similar, independent right under the 1st Amendment to attend all criminal proceedings in both federal and state courts.[4] Although the Supreme Court has never specifically held that the public has a First Amendment right of access to *civil* proceedings,[5] federal and state courts that have considered the issue have overwhelmingly held

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[1] The Office of Court Administration wishes to thank District Judge Roy Ferguson (394th) for primary authorship on this document.

[2] The Third Emergency Order Regarding the COVID-19 State of Disaster amended the First Emergency Order to remove the requirement that the court conduct the proceedings in the count of venue.

[3] Texas courts have recognized the juvenile's right to public proceedings in quasi-criminal juvenile justice cases under the 14th Amendment and Section 54.08 of the Texas Family Code. Article 1, Section 13 of the Texas Constitution states that "All courts shall be open, and every person for an injury done him in his lands, goods, person or reputation shall have remedy by due course of law." Courts construing this provision interpret it to prohibit the erection of barriers to the redress of grievances in the court system. So, the phrase "open courts" in Section 13 does not appear to mean "public trial."

[4] *Richmond Newspapers, Inc. v. Virginia*, 448 U.S. 555 (1980) (establishing that the 1st Amendment to the United States Constitution guarantees the public a right of access to judicial proceedings).

[5] Although the holding is specific to the criminal case, the constitutional analysis in *Richmond Newspapers* applies similarly to civil cases. As Chief Justice Burger in the majority opinion opined, "What this means in the context of trials is that the First Amendment guarantees of speech and press, standing alone, prohibit government from summarily closing courtroom doors which had long been open to the public at the time that Amendment was adopted." *Id.* at 576. In his concurrence, Justice Stevens wrote, "[T[he First Amendment protects the public and the press from abridgment of their rights of access to information about the operation of their government, including the judicial branch[.]" Justice Brennan added, "Even more significantly for our present purpose, […] open trials are bulwarks of our free and democratic government: public access to court proceedings is one of the numerous 'checks and balances' of our system, because 'contemporaneous review in the forum of public opinion is an effective restraint on possible abuse of judicial power[.]'" *Id.* And Justice Stewart specifically addressed the issue of civil cases, saying, "the First and Fourteenth Amendments clearly give the press and the public a right of access to trials themselves, civil as well as criminal." *Id.* at 599.

that there is a public right to access in civil cases under the 1st Amendment.[6] Courts must ensure and accommodate public attendance at court hearings.[7] However, although constitutional in nature and origin, the right to public and open hearings is not absolute, and may be outweighed by other competing rights or interests, such as interests in security, preventing disclosure of non-public information, ensuring a fair trial, or protecting a child from emotional harm.[8] Such cases are rare, however, as the presumption of openness adopted by the Supreme Court must be overcome in order to close hearings to the public.[9] In some instances, improper or unjustified closure of court proceedings constitutes structural error, requiring "automatic reversal and the grant of a new trial."[10]

The Texas Family Code expressly authorizes the limiting of public access by agreement in contested hearings involving SAPCR claims and rights.[11] If supported by appropriate findings made on the record, the court may limit attendance at the hearing to only those persons who have a direct interest in the suit or in the work of the court.[12] But because the constitutional right at issue belongs to the public rather than the parties, all closures or restrictions of public access to such hearings must satisfy the same heightened standards handed down by the Supreme Court in *Waller* regarding criminal cases – even when agreed to by the parties. Thus, while the court may consider the parties' agreement while evaluating a request for closure, that agreement alone is not sufficient to warrant closure. The 1st Amendment right belongs to the public – not to the parties; the parties cannot waive it by agreement.

It is the court's affirmative burden to ensure meaningful and unfettered access to court proceedings. In fulfilling this burden, the court must take all reasonable measures necessary to ensure public access.[13] Lack of access to a single hearing (suppression), or even a portion of a single hearing (voir dire), is enough to mandate reversal and a new trial. At this time, the movement of the general public is limited by the executive branch through the governor and various county judges. Shelter-in-place orders and prohibitions on non-essential travel prevent members of the general public from viewing hearings in the courthouse. While hearings in courthouses are no longer mandatory under the First Emergency Order Regarding the COVID-19 State of Disaster, the emergency order requires "reasonable notice and access to the participants and the public." Even if a judge is physically in a courtroom for the virtual hearing, it is the court's burden to ensure public access to each hearing and take reasonable measures to remove barriers thereto. There is no reasonable access to the public for a hearing, whether remote or physically located in a courthouse, when emergency measures are in place that would require the public to commit a jailable criminal offense to attend the hearing in person in a courtroom.[14] For the duration of this crisis and while these emergency orders are in effect, courts must find a practical and effective way to enable public access to virtual court proceedings. Choosing not to provide reasonable and meaningful public access to remote court proceedings at this time may equate to constitutional error and mandate reversal.

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[6] *See Doe v. Santa Fe Indep. School Dist.*, 933 F. Supp. 647, 648-50 (S.D. Tex. 1996) (discussing 3rd, 6th and 7th Circuit decisions and concluding that the right of the public to attend civil trials is grounded in the First Amendment as well as the common law).

[7] *See Lilly v. State*, 365 S.W.3d 321, 331 (Tex. Crim. App. 2012).

[8] *See United States v. Osborne*, 68 F.3d 94, 98-99 (5th Cir. 1995).

[9] *See In re A.J.S.*, 442 S.W.3d 562 (Tex. App.—El Paso 2014, no pet.)(discussing open courts in juvenile cases).

[10] Id. (citing *Steadman v. State*, 360 S.W.3d 499, 510 (Tex.Crim.App. 2012)(violation of 6th Amendment right)).

[11] Tex. Fam. Code § 105.003(b).

[12] Tex. Fam. Code. § 105.003.

[13] *See Lilly*, 365 S.W.3d at 331.

[14] *See* Executive Order GA-14 (March 31, 2020) and Tex. Gov't Code § 418.173.

Under the standards established by the United States Supreme Court, the protective measures employed must be limited to those necessary to protect an overriding interest and no broader. The trial court must consider all reasonable alternatives to closing the proceeding and make findings in open court on the record adequate to support the closure.[15] The court must weigh the totality of the circumstances in making these fact specific findings. For this reason, no standing order or global rule for closure of specific categories of hearings may be preemptively issued by a court without running afoul of the requirement to provide the public with access to court proceedings.

The court should not close the entirety of a hearing from public view in order to protect a single witness or topic of testimony. Because the court must apply only the least restrictive measures to protect the overriding interest, only specific portions of a hearing or trial that meet this exacting burden may be conducted outside of the public view, and that only in rare cases. Appellate courts have reversed judgments when a single less-restrictive solution existed but was not considered on the record.[16]

Courts should strongly consider employing protective measures short of interrupting or terminating the live stream. Federal courts, including the Fifth Circuit, have held that a partial closure of a proceeding – limiting access rather than excluding the public – does not raise the same constitutional concerns as a complete closure from public access.[17] To employ a less-restrictive measure (for example, temporarily obscuring video but not audio, or not displaying exhibits through screen share,[18] providing a phone number for the public to access the audio of the proceeding only, or providing a link that permits certain members of the public only to view the hearing either through a YouTube private link or a link to the Zoom meeting), the court need only find a "substantial reason" for the limitation and employ a restriction that does not exceed justifiable limits.[19] Terminating or interrupting the livestream without an alternative means for the public to view the hearing – even temporarily – would constitute a complete closure, and the higher burden would apply.

It bears mentioning that this is not a new issue created by video hearings or public livestreaming. Sensitive and embarrassing testimony is entered in every contested family law hearing yet rarely merits closure or clearing of courtrooms. Child protection cases categorically involve evidence that is or may be damaging or embarrassing to the child. Commercial disputes commonly involve protected internal corporate operations. Rarely – if ever – have such trials been closed to the public. Such testimony should not now be evaluated differently simply because more people may exercise their constitutional right to view court proceedings than ever before. Public exercise of a constitutional right does not change the court's evaluation of whether that right should be protected. Nor should courts erect barriers or hurdles to public attendance at hearings to discourage public exercise of that right. On the contrary, courts are required to take whatever steps are reasonably calculated to accommodate public attendance. Closure of courtrooms is constitutionally suspect and risky and should be a last resort.

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[15] *Waller v. Georgia*, 467 U.S. 39, 48, 104 S. Ct. 2210, 81 L. Ed. 2d 31 (1984).

[16] *See Cameron v. State*, 535 S.W.3d 574, 578 (Tex.App.—San Antonio 2017, no pet.)

[17] *United States v. Osborne*, 68 F.3d 94, 98-99 (5th Circ. 1995).

[18] The Supreme Court has ruled that the media does not have a First Amendment right to copy exhibits. *Nixon v. Warner Communications*, 435 U.S. 589 (1978).

[19] *A.J.S.*, 442 S.W.3d at 567 (citing *Osborne*, 68 F.3d at 94, and applying the 6th Amendment *Waller* and "substantial reason" standards to 14th Amendment public rights).

EXHIBIT D

IN THE SUPREME COURT OF TEXAS

Misc. Docket No. 92-0068

ADOPTION OF RULES FOR RECORDING AND BROADCASTING COURT PROCEEDINGS IN CERTAIN CIVIL COURTS OF TRAVIS COUNTY

ORDERED:

At the request of the civil district courts, county courts at law, and probate court of Travis County, the attached rules are adopted governing the recording and broadcasting of civil proceedings in those courts. TEX. R. CIV. P. 18c; TEX. R. APP. P. 21.

This Order shall be effective for each such court when it has recorded the Order in its minutes and complied with Texas Rule of Civil Procedure 3a(4).

SIGNED AND ENTERED this 11th day of March, 1992.

Thomas R. Phillips, Chief Justice

Raul A. Gonzalez, Justice

Oscar H. Mauzy, Justice

Eugene A. Cook, Justice

Jack Hightower, Justice

Nathan L. Hecht, Justice

Lloyd Doggett, Justice

John Cornyn, Justice

Bob Gammage, Justice

RULES GOVERNING THE RECORDING AND BROADCASTING OF COURT PROCEEDINGS IN CERTAIN CIVIL COURTS OF TRAVIS COUNTY

Pursuant to Rule 18c(a) of the Texas Rules of Civil Procedure, the following rules govern the recording and broadcasting of court proceedings before the civil district courts, county courts at law, and probate court of Travis County, and their masters and referees.

1. Policy. The policy of these rules is to allow media coverage of public civil court proceedings to facilitate the free flow of information to the public concerning the judicial system, to foster better public understanding about the administration of justice, and to encourage continuing legal education and professionalism by lawyers. These rules are to be construed to provide the greatest access possible while at the same time maintaining the dignity, decorum and impartiality of the court proceeding.

2. Definitions. Certain terms are defined for purposes of these rules as follows.

2.1. "Court" means the particular court, master or referee in which the proceeding will be held.

2.2. "Media coverage" means any visual or audio coverage of court proceedings by a media agency.

2.3. "Media" or "media agency" means any person or organization engaging in news gathering or reporting and includes any newspaper, radio or television station or network, news service, magazine, trade paper, in-house publication, professional journal, or other news reporting or news gathering agency.

2.4. "Visual coverage" means coverage by equipment which has the capacity to reproduce or telecast an image, and includes still and moving picture photographic equipment and video equipment.

2.5. "Audio coverage" is coverage by equipment which has the capacity to reproduce or broadcast sounds, and includes tape and cassette sound recorders, and radio and video equipment.

3. Media coverage permitted.

3.1. Media coverage is allowed in the courtroom only as permitted by Rule 18c of the Texas Rules of Civil Procedure and these rules.

3.2. If media coverage is of investiture or ceremonial proceedings as allowed by Rule 18c(c) of the Texas Rules of Civil Procedure, permission for, and the manner of such coverage, are determined solely by the court, with or without guidance from these rules. If media coverage is for other than investiture or ceremonial proceedings, that is, under Rule 18c(a) or (b) of the Texas Rules of Civil Procedure, the provisions of these rules shall govern.

3.3. Media coverage under Rule 18c(a) and (b) of the Texas Rules of Civil Procedure is permitted only on written order of the court. A request for an order shall be made on the form included in these rules. The following procedure shall be followed, except in extraordinary circumstances and only if there is a finding by the court that good cause justifies a different procedure: (i) the request should be filed with the district clerk or county clerk, depending upon the court in which the proceeding is pending, with a copy delivered to the court, court administrator, all counsel of record and, where possible, all parties not represented by attorneys, and (ii) such request shall be made in time to afford the attorneys and parties sufficient time to confer, to contact their witnesses and to be fully heard by the court on the questions of whether media coverage should be allowed and, if so, what conditions, if any, should be imposed on such coverage. Whether or not consent of the parties or witnesses is obtained, the court may in its discretion deny, limit or terminate media coverage. In exercising such discretion the court shall consider all relevant factors, including but not limited to those listed in rule 3.5 below.

3.4. If media coverage is sought with consent as provided in Rule 18c(b) of the Texas Rules of Civil Procedure, consent forms adopted by the court shall be used to evidence the consent of the parties and witnesses. Original signed consent forms of the parties shall be attached to and filed with the request for order. Consent forms of the witnesses shall be obtained in the manner directed by the court. No witness or party shall give consent to media coverage in exchange for payment or other consideration, of any kind or character, either directly or indirectly. No media agency shall pay or offer to pay any consideration in exchange for such consent.

3.5. If media coverage is sought without consent, pursuant to Rule 18c(a) of the Texas Rules of Civil Procedure, the decision to allow such coverage is discretionary and will be made by the court on a case by case basis. Objections to media coverage should not be conclusory but should state the specific and demonstrable injury alleged to result from media coverage. If the court denies coverage, it shall set forth in its order the findings upon which such denial is based. In determining an application for coverage, the court shall consider all relevant factors, including but not limited to:

(a) the type of case involved;

(b) whether the coverage would cause harm to any participants;

(c) whether the coverage would interfere with the fair administration of justice, advancement of a fair trial, or the rights of the parties;

(d) whether the coverage would interfere with any law enforcement activity;

(e) the objections of any of the parties, prospective witnesses, victims, or other participants in the proceeding of which coverage is sought;

(f) the physical structure of the courtroom and the likelihood that any equipment required to conduct coverage of proceedings can be installed and operated without disturbance to those proceedings or any other proceedings in the courthouse;

(g) the extent to which the coverage would be barred by law in the judicial proceeding of which coverage is sought; and

(h) the fact that any party, prospective witness, victim, or other participant in the proceeding is a child, to which fact the court shall give great weight.

4. Media coverage prohibited

4.1. Media coverage of proceedings held in chambers, proceedings closed to the public, and jury selection is prohibited. Audio coverage and closeup video coverage of conferences between an attorney and client, witness or aide, between attorneys, or between counsel and the court at the bench is prohibited.

4.2. Visual coverage of potential jurors and jurors in the courthouse is prohibited except when in the courtroom the physical layout of the courtroom makes it impossible to conduct visual coverage of the proceeding without including the jury, and the court so finds. In such cases visual coverage is allowed only if the jury is in the background of a picture of some other subject and only if individual jurors are not identifiable.

5. Equipment and personnel. The court may require media personnel to demonstrate that proposed equipment complies with these rules. The court may specify the placement of media personnel and equipment to permit reasonable coverage without disruption to the proceedings. Unless the court in its discretion and for good cause orders otherwise, the following standards apply.

5.1. One television camera and one still photographer, with not more than two cameras and four lenses, are permitted.

5.2. Equipment shall not produce distracting sound or light. Signal lights or devices which show when equipment is operating shall not be visible. Moving lights, flash attachments, or sudden lighting changes shall not be used.

5.3. Existing courtroom sound and lighting systems shall be used without modification. An order granting permission to modify existing systems is deemed to require that the modifications be installed, maintained, and removed without public expense. Microphones and wiring shall be unobtrusively located in places approved by the court and shall be operated by one person.

5.4. Operators shall not move equipment or enter or leave the courtroom while the court is in session, or otherwise cause a distraction. All equipment shall be in place in advance of the proceeding or session.

5.5. Identifying marks, call letters, words and symbols shall be concealed on all equipment. Media personnel shall not display any identifying insignia on their clothing.

6. Delay of proceedings. No proceeding or session shall be delayed or continued for the sole purpose of allowing media coverage, whether because of installation of equipment, obtaining witness consents, conduct or hearings related to the media coverage or other media coverage questions. To assist media agencies to prepare in advance for media coverage, and when requested to do so: (i) the court will attempt to make the courtroom available when not in use for the purpose of installing equipment; (ii) counsel (to the extent they deem their client's rights will not be jeopardized) should make available to the media witness lists; (iii) and the court administrator will inform the media agencies of settings or proceedings.

7. Pooling. If more than one media agency of one type wish to cover a proceeding or session, they shall make pool arrangements. If they are unable to agree, the court may deny media coverage by that type of media agency.

8. Official record. Films, videotapes, photographs or audio reproductions made in the proceeding pursuant to these rules shall not be considered as part of the official court record.

THE SUPREME COURT OF TEXAS

P.O. BOX 12248 AUSTIN, TEXAS 78711
TEL: (512) 463-1312
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CHIEF JUSTICE
THOMAS R. PHILLIPS

JUSTICES
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NATHAN L. HECHT
LLOYD DOGGETT
JOHN CORNYN
BOB GAMMAGE

CLERK
JOHN T. ADAMS

EXECUTIVE ASS'T.
WILLIAM L. WILLIS

ADMINISTRATIVE ASS'T.
MARY ANN DEFIBAUGH

September 22, 1992

Ms. Amalia Mendoza
District Clerk
Post Office Box 1748
Austin, Texas 78767

Dear Ms. Mendoza,

Enclosed, please find a **corrected** copy of the order of this Court of March 11, 1992 that approved local rules for recording and broadcasting court proceedings in certain civil courts of Travis County. Please destroy previous versions of this order.

Sincerely,

SIGNED

John T. Adams
Clerk

Encl.

cc:
Hon. B. B. Schraub
3rd Admin Judicial Rgn

Hon. Joseph H. Hart
126th District Court

County Clerk

Mr. Ray Judice
Office of Court Admin

State Law Library

Chmn Supreme Ct Adv Committee

JOSEPH H. HART
DISTRICT JUDGE
126TH JUDICIAL DISTRICT COURT

P. O. BOX 1748
AUSTIN, TEXAS 78767

April 17, 1992

Justice Nathan L. Hecht
Supreme Court of Texas
P. O. Box 12248
Austin, Texas 78711

Dear Justice Hecht:

Thank you for forwarding to me a copy of the Order recently issued by the Supreme Court adopting rules for recording and broadcasting court proceedings in civil courts in Travis County. A few omissions and errors have been brought to my attenion that the Court may wish to change.

There is some inconsistency between the first paragraph of the rules and paragraph 2.1. The opening paragraph does not include district court masters and referees, while paragraph 2.1 does. Paragraph 2.1 does not include county courts at law and the probate court of Travis County, while the opening paragraph does. I believe we intended to have all of the courts covered by the rules, and they all should be included in both the opening paragraph and paragraph 2.1.

In paragraph 3.5(c) the conjunction "and" was probably included inadvertently and is not necessary.

The last sentence of paragraph 4.2 reads in part as follows: "In such cases visual coverage is allowed only of the jury is in the background of a picture ...." The "of" should be changed to "if" so that the sentence begins as follows: "In such cases visual coverage is allowed only if the jury is in the background of a picture ...."

Paragraph 5.1 reads in part as follows: "One television camera and one still photographers ..." The word should be "photographer," singular, rather than "photographers," plural.

Thank you, the Court and your staff for working with us on these rules. If there is a problem in making the corrections, please let me know.

Very truly yours,

JOSEPH H. HART
Judge, 126th District Court
Travis County, Texas

JHH/bjv

Tab I

Memorandum
On Proposed Changes to TRCP 18c on Recoding and Broadcasting of Court Proceedings

August 12, 2024

From: Richard R. Orsinger, Chair
Subcommittee on Rules 15-165a
of the Supreme Court Advisory Committee

Chief Justice Hecht, in his letter of July 17, 2024, referred to the Supreme Court Advisory Committee the November 9, 2021 Report and Recommendations of Subcommittee 1 of the Remote Proceedings Task Force. Task 1 mentioned in the Report related to Rules for Recording and Broadcasting proceedings in Texas trial courts. Having reviewed Task Force Subcommittee 1's observations and proposed changes to Texas Rule of Civil Procedure 18c, the Subcommittee on Rules 15-165a presents this Memorandum.

1. **Correlation with Appellate Rules.** The Task Force Subcommittee considered TRCP 18c and Tex. R. App. P. 14 together. The Subcommittee on Rules 15-165a agrees that the two rules should be considered together, but the benefits and risks of permitting or requiring broadcasting, televising, recording or photographing of proceedings in the trial courts are different from in appellate courts.

2. **The Current Rule.** The language of current Rule 18c, adopted in 1990, provides: RULE 18c. RECORDING AND BROADCASTING OF COURT PROCEEDINGS

   A trial court may permit broadcasting, televising, recording, or photographing of proceedings in the courtroom only in the following circumstances:

   > (a) in accordance with guidelines promulgated by the Supreme Court for civil cases, or
   >
   > (b) when broadcasting, televising, recording, or photographing will not unduly distract participants or impair the dignity of the proceedings and the parties have consented, and consent to being depicted or recorded is obtained from each witness whose testimony will be broadcast, televised, or photographed, or
   >
   > (c) the broadcasting, televising, recording, or photographing of investiture, or ceremonial proceedings.

   The Comment to this Rule said: "New rule. To provide for guidelines for broadcasting, televising, recording, and photographing court proceedings."

3. **Trial Court Discretion.** Current Rule 18c gives the trial court discretion whether to permit the broadcasting, televising, recording, or photographing ("BTRP") of trial court proceedings. The question arises whether this should continue to be in the trial court's discretion, or whether BTRP should be mandated for all trial court proceedings and, if so, whether certain exceptions should be recognized. The Comment to Tex. R. App. 14 says that the Rule "allows recording and broadcasting of court proceedings at the discretion of the court and subject to the stated guidelines." The reference is to the guidelines stated in TRAP 14. A question to be addressed for TRCP 18c is whether guidelines should be stated in the Rule, or in some other manner.

4. **Consent of Participants.** The Task Force Report noted that "current Rule 18c appears to require consent of participants before a proceeding can be recorded or broadcast." Report, p. 1. Current Rule 18c(b) makes it a condition to BTRP that the parties consent, and that the consent to being "depicted and recorded" be obtained from each witness whose testimony will be "broadcast, televised, or photographed." Depicting and recording seems to be equated to broadcasting, televising, and photographing. Could depicting mean a drawing by a courtroom sketch artist? Does consent to recording equate to consent to broadcasting, televising and photographing? Does broadcast mean audio only, as distinguished from audio and visual? The inference is that a proceeding cannot be BTRP without the consent of all parties, and that the testimony of a witness cannot be BTRP without the consent of that witness. No mention is made of how and when notice is to be provided to the parties and each witness. No mention is made of whether and how and when notice is made to the public, in contrast to TRCP 76a, which requires notice to the public of the sealing of court records. And no mention is made of the right to object, or the standards that apply upon objection. The same is true if a party wants to request that a proceeding the BTRP when that is not planned by the trial court.

5. **Supreme Court Guidelines.** The requirement of consent in current Rule 18c(b) is, however, only one of three disjunctive conditions for publication. The others are that BTRP is permitted: (a) is "in accordance with guidelines promulgated by the Supreme Court for civil cases," or (c) "the broadcasting, televising, recording, or photographing of investiture, or ceremonial proceedings." So consent is not required if guidelines are promulgated by the Supreme Court and these guidelines are adhered to.

6. **Cameras in the Courtroom.** The Task Force subcommittee noted that TRCP 18c and TRAP 14 were promulgated in contemplation of a television camera in the courtroom with expected broadcast on the evening newscast. The current capability is to live-stream court proceedings on the internet where they can be conveniently viewed around the world and will not doubt be permanently recorded for replay at any time.

7. **Does an Open Courtroom Satisfy Public Access?** The Task Force Subcommittee said that "any 'right to access'" is not an unfettered right. The Task Force Subcommittee said that there was no established "right" to remote access to court proceedings. The necessity for that arose during the COVID-19 closures but no longer exists and is a matter of choice post- COVID. TO what extent, if any, there is a right to access via the internet is a question to be considered in rewriting Rule 18c. The Rules 15-165a Subcommittee believes that public policy, the public interest, privacy considerations, potential misuse, and the impact on trial proceedings should be thoroughly considered in connection with modernizing Rule 18c.

8. **Sensitive and Protected Information.** The Task Force Subcommittee said that "sensitive and protected information" must be protected, and should be addressed in any new rules. The Subcommittee mentioned trade secrets. Sensitive data is addressed in Tex. R. Civ. P. 21c, Privacy Protection for Filed Documents, and is defined to include "1) a driver's license number, passport number, social security number, tax identification number, or similar government-issued personal identification number; (2) a bank account number, credit card number, or other financial account number; and (3) a birth date, a home address, and the name of any person who was a minor when the underlying suit was filed." Rule 21c applies only to documents filed with the court, presumably meaning the clerk of the court or the judge. It does not seem that Rule 21c applies to marking exhibits in court proceedings, or testifying to sensitive data contained in documents, or lawyers mentioning sensitive data in addressing the court or a jury. Notably, Rule 21c(f) says: "Restriction on Remote Access. Documents that contain sensitive data in violation of this rule must not be posted on the Internet." It would seem that the same policy that applies to filed documents would apply to exhibits, testimony, and argument in a court proceeding. Also to be considered is TRCP 192.6, Protective Order, which recognizes the right of a party from whom discovery is sought, or who may be affected by a discovery request, to move for a protective order "[t]o protect the movant from undue burden, unnecessary expense, harassment, annoyance, or invasion of personal, constitutional, or property rights." To what extent do those same considerations apply to testimony, exhibits, and argument in a courtroom proceeding? TRCP 76a permits sealing of court records only upon the showing of "(a) a specific, serious and substantial interest which clearly outweighs: (1) this presumption of openness; [and] (2) any probable adverse effect that sealing will have upon the general public health or safety… " The question can be asked if any of these standards should be used in connection with BTRP of courtroom proceedings. The Texas Trade Uniform Secret Act applies only to proceedings where a party is seeking to recover damages under Chapter 134A of Tex. Civ. Prac. & Rem. Code ch. 134A. Section 134A.006 describes steps courts can take to preserve secrecy by issuing "[p]rotective orders [that] may include provisions limiting access to confidential information to only the attorneys and their experts, holding in camera hearings, sealing the records of the action, and ordering any person involved in the litigation not to disclose an alleged trade secret without prior court approval." Section 134A.006 even permits courts to "exclude a party and the party's

representative or limit a party's access to the alleged trade secret of another party " Whether these legislative standards should influence the court rule is a valid question to ask.

9. **Remote Proceeding.** The Task Force Subcommittee suggested consideration of remote proceedings in which the court is conducting a hearing on-line, where there is no proceeding in the physical courtroom. The Rules 15-165a Subcommittee believes that guidance is needed on whether and how to allow the public to participate in court proceedings conducted solely on-line and not in the courtroom.

10. **Right to Access.** The Task Force Subcommittee raised the question of what is the public's right to access to civil court proceedings? The topic was not discussed in depth in the Subcommittee's Report, but the issue was recently written about and discussed in the Supreme Court Advisory Committee's deliberations regarding the possible amendment of TRCP 76a.

11. **Greater Risks With New Technology.** The Task Force Subcommittee commented that the potential for misuse is greater with on-line sites such as YouTube, which do not benefit from editorial oversight of television news programs. The Subcommittee also mentioned security risks for participants and the possibility of manipulation of recordings. In the past, the SCAC has discussed "Practical Obscurity," which has been defined as "the principle that private information in public records is effectively protected from disclosure as the result of practical barriers to access," with further explanation that "practical barriers to access include travel to view the record, the passage of time, and the limits of indexing. When public records are accessible on the internet, those barriers are diminished."[1] Also, given today's computing power it is possible for digital records to be altered in a way that is hard to detect. And some media would permit the posting of public comments about a court proceeding, either contemporaneous with the proceeding or afterward.

12. **Different Procedures Depending on the Type of Media.** The Task Force Subcommittee asked whether different factors should be considered for traditional media versus court-controlled internet broadcast. The Rule 15-165a Subcommittee believes that new technologies create new avenues of access to court proceedings but also new dangers of misuse and possible negative effects on court proceedings, such as reluctance of potential jurors to answer questions candidly during jury selection, or reluctance of witnesses to testify while being recorded or broadcast, if proceedings are being disseminated on the internet.

13. **Rule Versus Standards.** The Task Force Subcommittee asked "how detailed should the rule be?" The Rule 15-165a Subcommittee raises the questions of whether there should be rules or instead should be standards, and if there are standards then what should they say and how should they be promulgated? Is there a presumption of openness as under TRCP 76a, or a presumption in favor of granting protective orders relating to alleged trade secrets like the Trade Secrets'

Act, or no presumption at all?

14. **Notice and Opportunity to Heard.** The final discussion point made by the Task Force Subcommittee related to the opportunity to object to recording/broadcasting and even to seek mandamus review before hearing or trial. If the trial court has a standing policy on recording/broadcasting, the duty naturally falls on the parties or witnesses to raise their objection before the hearing or trial. Where the trial court does not have a standing policy on recording/broadcasting, then should that decision to record/broadcast be made sufficiently in advance of the event to give an opportunity for a party or witness to object and seek mandamus review? Then there is the question of courts that do not routinely record/broadcast proceedings and whether a party can move for the court to allow the recording/broadcast of a court proceeding.

15. **The Proposed New Rule 18c.** The Task Force Subcommittee's Report presented as Exhibit A a proposed revised TRCP 18c, consisting of six subparts. The Rules 15-165a Subcommittee discussed this proposed Rule and has the following comments.

16. Proposed Rule 18c.1 relates to parties or third-parties making recordings or broadcasting court proceedings. The proposed rule makes recording or broadcasting permissive, not mandatory, at the trial court's discretion, but subject to rules or standards adopted by the Supreme Court. Ceremonial activities are excepted, and are subject to the trial court's discretion without regard to the Rules of Procedure. Perhaps rules of standards should be promulgated that apply to ceremonial activities, since there may be public interest in the swearing-in of judges, and the like. It would be good to clarify what is meant by "recording" and "broadcasting," since those activities could overlap or differ, and broadcasting has been understood to mean transmitting by radio or television when dissemination via the internet is the greater issue. Also, it should be clarified that "recording" as used in this rule is different from the court reporter's stenographic recording or audio recording of the court proceedings.

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[1] Dictionary of Archives Terminology <https://dictionary.archivists.org/entry/practical-obscurity.html>.

17. Proposed Rule 18c.2 relates to the court making recordings or broadcasting court proceedings. It requires the court to give advance notice of the intent to record or broadcast. Not recording or broadcasting is the default, as there is no requirement that a court give notice that a proceeding (or proceedings generally) will not be recorded or broadcast. The Rules 15-165a Subcommittee concurs with the idea that parties can object to recording or broadcasting. Note that the proposed Rule 18c.2 eliminates the requirement under current Rule 18c of consent of parties and each witness, leaving the matter purely discretionary with the court. This step should be discussed thoroughly as it is a major policy change. The proposed rule limits the court's discretion to "a court-controlled medium." The meaning of that term needs to be made clear.

18. Proposed Rule 18c.3 relates to a party wishing to "cover" a court proceeding. This is phrased as if addressing a journalist, radio or television reporter, or other news professional will attend in person with a camera and microphone. Consideration should be given to professionals or non-professionals seeking remote access and permission to record the proceeding. The proposed rule includes "images," meaning photographs and perhaps drawings, with no audio recording. Proposed Rule 18c.3(b) permits parties to object, but not witnesses. Persons summoned for jury duty and participating in jury selection are not mentioned. The proposed rule requires the objecting party to state a "specific and demonstrable injury alleged to result from coverage." This standard differs from TRCP 21c, and TRCP 76a and TRCP 192.6, and the question arises whether it is the best articulation of the policy involved. The proposed rule allows but does not require the court to conduct a hearing on the objection to recording/broadcasting. This is in contrast to TRCP 76a.4 which requires a hearing.

19. Proposed Rule 18c.4 lists factors that the court may consider in deciding whether to record or broadcast a court proceeding. Many of the factors are case-specific, which would seem to weigh against a court adopting a standing policy to disseminate all court proceedings on YouTube or other internet service.

20. Proposed Rule 18c.5 says that a video or audio "reproduction" of a proceeding is not part of the official record. The Rules 15-165a Subcommittee agrees with this suggestion.

21. Proposed Rule 18c.6 says that persons who violate the court's order may be subject to disciplinary action "up and including contempt." The proscription applies to "imagery," which needs to be defined.

22. The Rules 15-165a Subcommittee has prepared a proposed version of a new Rule 18c, which is attached to this Memorandum.

23. The Rules 15-165a Subcommittee believes that there are issues of judicial ethics that should be considered for inclusion in the Texas Code of Judicial Conduct, or in guidelines promulgated by the Supreme Court, regarding judges not engaging in on-line conversations or posting comments about pending cases. But that raises the question of whether judges can "defend themselves" from criticism posted on-

line.

24. The Rules 15-165a Subcommittee summarizes its discussions with the following points:

(1) Most of the concerns outlined in the referral letter relate to ethical matters, and they should be addressed within the Code of Judicial Conduct:

a. extraneous judicial commentary and extrajudicial remarks made in connection with such proceedings;

b. permitting the posting of public comments in reaction to official court proceedings and judicial responses to such commentary; and

c. the acceptance of financial compensation in connection with posting official court proceedings.

(2) The rules in the trial courts should be drafted in consideration of the rules governing appellate courts; they are not the same but should be consistent.

(3) The Supreme Court should consider what to include in Rules of Procedure, what to included in Comments to the Rules, and what to promulgate in other ways, such as Miscellaneous Orders or instructional pamphlets disseminated through judicial continuing education. For example, the factors listed in proposed Rule 18c.4 may be better placed in something other than a rule of procedure.

(4) As stated in proposed Rule 18c.5, recordings such as these should not be considered a court record. There should be no obligation for the court or court reporter to maintain these kinds of recordings.

(5) The ability to punish violation of the rules of court by contempt is fine, but not calling it a disciplinary action.

(6) The Subcommittee did not achieve consensus on whether "broadcast" meant television and radio only, or additionally live-streaming on the internet. There was also not consensus on whether courts should be required to keep these types of recordings for later access by the public. And there was not consensus whether there should be a uniform rule for all trial courts, or whether each court should be free to do as it wishes, guided by standards or following rules promulgated by the Supreme Court. The Subcommittee did not achieve consensus on whether there is a "right" to privacy and, if so, whether it should be listed as a factor to be weighed.

25. It should be noted that TRCP 76a, on sealing court records, does not apply to action originally arising under the Family Code. Consideration should be given to applying that exemption to recording and broadcasting Family Law proceedings

which frequently involve sensitive financial and private information and privileged information.

26. The Executive Committee of the Family Law Council of the State Bar of Texas' Family Law Section has submitted a memorandum of thoughts which should be considered as part of the discussions surrounding amending Rule 18c. A copy of that memorandum is included in the Agenda for the August 16, 2024 Supreme Court Advisory Committee meeting.

SCAC Subcommittee for Rules 15-165a's Proposed Revisions to TRCP 18c:

18c.1 Recording and Broadcasting Permitted

(a) Recording and Broadcasting by the Court

A trial court may record or broadcast courtroom proceedings over which the trial court presides via a court-controlled medium in accordance with this rule and any standards adopted by the Texas Supreme Court.

(b) Recording and Broadcasting by Others

A trial court may permit courtroom proceedings to be recorded or broadcast in accordance with this rule and any standards adopted by the Texas Supreme Court.

(c) Notice and Objection

The trial court must give reasonable notice to the parties if a proceeding will be recorded or broadcast. Reasonable notice may include the court's written policy stating the types of proceedings recorded and broadcasted as a matter of course and the medium of broadcasting. Parties may object to a proceeding being recorded or broadcast by following the procedures and standards set forth in this rule.

(d) Exceptions

This rule does not apply to an investiture or other ceremonial proceedings, which may be broadcast or recorded at the trial court's sole discretion, with or without guidance from these rules.

(e) Written Policy

Each court must have a written policy governing recording and broadcasting of court proceedings, which will be posted on the TOPIC website maintained by OCA.

Comments:

a. Need to define "recording" and "broadcasting" – Live only? Or uploaded and made available?

b. Will we require trial courts to take down recordings after a specified time?
c. Need to define "court-controlled" – does it include services like YouTube, as long as it's a channel maintained by the court? Or does it mean court websites only?

~~18c.2 Recording and Broadcasting as a Matter of Course~~

[combined into 18c.1.]

~~18c.3 Procedure Upon Request~~

[Remove this level of detail from the rules. These topics should be covered within each court's written policy.]

~~18c.4 Decision of the Court~~

[Remove this from the Rules. These standards should be published in "standards adopted by the Texas Supreme Court.]

18c.5 Official Record

Video or audio reproductions of a proceeding pursuant to these rules shall not be considered as part of the official court record.

18c.6 Violations of Rule

Any person who records, broadcasts, or otherwise disseminates the audio, video, or imagery of a court proceeding without approval in accordance with this rule may be subject to disciplinary action by the court, up to and including contempt.

END

Tab J

October 31, 2024

Texas Supreme Court Advisory Committee
Subcommittee on Rules 15-165a

Memo on TRCP 18c, Recording and Broadcasting Court Proceedings

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1. Referral: On July 17, 2024, Chief Justice Nathan Hecht referred to the Supreme Court Advisory the following matter:

> Recording and Broadcasting Court Proceedings. The Committee discussed the attached proposed changes to Texas Rule of Civil Procedure 18c and Texas Rule of Appellate Procedure 14 at its September 30, 2022 meeting. Since that time, issues have arisen regarding the recording and broadcasting of official court proceedings. Among those reported are extraneous judicial commentary and extrajudicial remarks made in connection with such proceedings; the prolonged availability of proceedings in cases involving sensitive data; permitting the posting of public comments in reaction to official court proceedings and judicial responses to such commentary; and the acceptance of financial compensation in connection with posting official court proceedings. These reports are rare but concerning. The Court requests that the Committee revisit its earlier work in light of these concerns, considering all case types, and recommend amendments.

The matter was referred to the Subcommittee on Rules 15 - 165a.

2. Task Force Report: The Supreme Court appointed a Remote Proceedings Task Force, which issued a Report and Recommendations on November 9, 2021. The Task Force evaluated recording court proceedings in both trial and appellate courts. The Task Force concluded that TRCP 18c “appears to require consent of participants before a proceeding can be recorded or broadcast.” [Report, p. 1] The Rule permits the recording with the consent of the parties and from each witness or alternatively “in accordance with guidelines promulgated by the Supreme Court for civil cases ....” The Supreme Court never issued guidelines, so effectively consent was required to record and broadcast.

3. Current Rule 18c. The current version of Rule 18c, adopted in 1990 (34 years ago), provides:

> RULE 18c. RECORDING AND BROADCASTING OF COURT PROCEEDINGS
>
> A trial court may permit broadcasting, televising, recording, or photographing of

proceedings in the courtroom only in the following circumstances:

> (a) in accordance with guidelines promulgated by the Supreme Court for civil cases, or
>
> (b) when broadcasting, televising, recording, or photographing will not unduly distract participants or impair the dignity of the proceedings and the parties have consented, and consent to being depicted or recorded is obtained from each witness whose testimony will be broadcast, televised, or photographed, or
>
> (c) the broadcasting, televising, recording, or photographing of investiture, or ceremonial proceedings.

Notes and Comments

Comment to 1990 change: New rule. To provide for guidelines for broadcasting, televising, recording, and photographing court proceedings.

4. <u>Statewide Control.</u> On September 4, 2024, Chief Justice Hecht wrote a letter to Megan LaVoie, Administrative Director of the Texas Office of Court Administration, regarding a state-sponsored and state-controlled broadcast arrangement for Texas courts. The letter asked:

> I'm writing to ask that your office research the anticipated costs and feasible timeline associated with the implementation of a statewide broadcasting system for official court proceedings. Currently, there is a lack of uniformity in this area, and a state-provided platform could save judges and staff valuable time and prevent potential problems in areas such as ownership of the broadcasted content, commentary and other technical settings, privacy, information security, and ethical conduct.
>
> In addition to studying the anticipated costs and timeline of such a project, I also request that OCA look at potential sources of funding within the judicial branch, if available. Please submit an initial report no later than November 18, 2024.

5. <u>High-Level Questions.</u> There are several approaches to the issues of recording and broadcasting. One is a categorical approach, like recording and broadcasting are always permitted or never permitted. Another is that trial courts should never do the recording or broadcasting versus trial courts are the only one who can record and broadcast. If recording and broadcasting is permitted, is consent required or is the matter discretionary with the trial court? If discretionary, is it permitted only if a party or non-party requests it, and do parties

and witnesses have a right to object and secure a ruling? Should that recording and broadcasting of some persons, like jurors faces or testifying minors, be prohibited? Can a witness be recorded or broadcast with the face blurred?

A list of high-level issues would include:

- does new technology require electronic access to court proceedings
- is recording/broadcasting always, sometimes, or never permitted
- is consent of participants required or is it discretionary with the trial court
- is recording/broadcasting permitted only upon request
- who can object to recording/broadcasting; what must they show as grounds
- does the trial court or do private persons do the recording and broadcasting
- who owns the recording; who has the right to broadcast; who gets the profits
- are different rules needed for recording versus broadcasting
- should recording/broadcasting some types of cases be permitted and other prohibited
- should recording/broadcasting be cut-off for certain types of evidence

6. <u>Public's Right to Access.</u> An issue to be considered is the public's right to access to civil court proceedings. Historically that access was granted by allowing members of the public to enter the courtroom to watch the proceedings. Is it a good policy to continue that spatially-oriented approach, even though we have the ability to record and broadcast civil court proceedings and broadcast them to the world?

If the Court is going to conduct a hearing by Zoom, must the Judge be in the courtroom with the remote proceedings viewable from the audience? If the Judge and all participants will be participating remotely, can the public access requirement be met by having the proceeding viewable from an otherwise empty courtroom? Should the public's right to access be a right to remote access, without having to physically come to the courtroom to watch proceedings? If remote access is not required, is a court permitted to feed a court proceeding live to an internet site, or is a court permitted to record a court proceeding and later make the recording available on the internet.

7. <u>Privacy Considerations.</u> Are considerations of privacy to be weighed against the public interest in access to court proceedings? Can recording and broadcasting be curtailed in order to limit access to confidential or privileged information just to participants? Can recording and broadcasting be curtailed to avoid embarrassment or risk of reputational, psychological, or physical harm to participants or non-participants?

8. <u>Who Owns a Recording of a Court Proceeding?</u> Is a recording of a court proceeding the property of the person who makes the recording? Can the recording be used for profit purposes? Can a Judge use a recording for political purposes? Will the state of Texas own

the recording and control its broadcasting? If the court reporter records the proceedings digitally as well as by shorthand, is that recording a public record that can be obtained and published? Can the court's recording be used as the reporter's record in an appeal, or can the recording be used to impeach the written reporter's record?

9. Standing Rule. Should each court be allowed to establish a policy that all, or some, or no cases can be recorded and broadcast? For example, can a court decide that all cases involving the State of Texas as a party will be recorded and broadcast? Can a court decide that all cases involving the termination of parental rights may not be recorded?

10. Rule 76a Standards and Procedures. Similar policy questions have been addressed connection with the sealing of court records under TRCP 76a. Possible parallels would include:

- Should a court's rendition of judgment be freely recordable and subject to broadcast?
- If discretionary, is there a presumption of openness?
- Is the evaluation process initiated by a request or instead an objection?
- If discretionary, must a proponent show a specific, serious and substantial interest that will be impaired by recording or broadcasting?
- Is it a factor whether there will be a probable adverse effect upon the general public health or safety from denying recording or broadcasting?
- Is the court required to employ the least restrictive limitation on recording and broadcasting that will adequately and effectively protect the specific interest asserted?
- Is a written motion required to seek permission or oppose recording and broadcasting? Is a public hearing required? Is notice of that hearing required? Can members of the public be heard?
- Is there review by an appellate court of the decision of the trial court?
- If recording is allowed but broadcasting is not, does the court have continuing jurisdiction to revisit broadcasting at a later time?

11. Two Proposed Rules. The Subcommittee has prepared two rules that reflect different approaches to these issues. One is a rule requiring consent from the parties to record a proceeding, and consent from each witness whose testimony would be recorded. The other is a rule giving the trial court discretion whether or not to require or allow the recording and broadcasting of a court proceeding. Both rules are attached to this Memo.

12. Different Perspectives. The Subcommittee members entertained many different views on these issues, that varied from no change from historical practices, to a blanket prohibition against recording and broadcasting, to leaving each court with the discretion to decide. No

member supported blanket permission for the state or private persons to record and broadcast court proceedings.

13. Other Thoughts. A member of the Subcommittee expressed these ideas:

The risks to fair trials, participants (parties, witnesses, judges and their staffs) and non-participants (anyone mentioned or arguably implicated by anything any witness says) are higher than ever now. Anyone can slice anything out of anything digital, alter it, misrepresent it, and post it on X, forever and for the whole world to see, with little risk of any sanction of any kind.

Trial judges cannot be expected to manage these risks in real time. They do not have the training, experience, or resources to do so and have more than enough already to do to ensure fair trials.

There is one possible way to disseminate court proceedings that might be worth exploring: a state run system. This would require expenditures for which appropriations would be required not only for equipment but for hiring of trained and experienced professionals at OCA and in the courthouses.

Such system could include no real-time dissemination, but only after lags for vetting. Dissemination could perhaps be controlled to some degree by contracts setting content moderation standards and abuse protections.

The recordings might be good for the judicial system - transparency and credibility. They would be useful to journalists, both professional and amateur, and an informed citizenry at large. They would also be useful in law schools (and high school civics classes, college government, pre law, history, etc.) and to scholars.

This still might not be a good idea. I'm not sure elected trial judges should be at risk of being seen, and then graded, on excerpts from their worst days.

Respectfully submitted,

Richard R. Orsinger
Subcommittee Chair

Tab K

Recording and Disseminating Court Proceedings

18 c.1 Definitions of Recording and Disseminating Recording of Court Proceedings

(a) **Recording:** using a device to capture the sound or image of any aspect of a court proceeding.

(b) **Disseminating:** conveying or transferring a recording of any aspect of a court proceeding;

(c) "Recording" and "disseminating" under this rule does not prohibit participants appearing remotely under Rule 21d or recordings made by the trial court to assist in the preparation of the reporter's record.

18 c.2 Limits On Recording and Disseminating of Court Proceedings

Except for investitures or other ceremonial proceedings, which may be recorded, and disseminated at the trial court's sole discretion, a trial court may only permit court proceedings to be recorded or disseminated in accordance with this rule and any standards adopted by the Texas Supreme Court.

18 c.3 Recording and Disseminating of Court Proceedings by the Trial Court

(a) A trial court may not record or disseminate court proceedings using any medium other than one approved [and provided] by the Office of Court Administration. All such recordings and disseminating of court proceedings by the trial court are the property of the State of Texas, not the property of the trial court or the parties to or witnesses in the case.

(b) In order to record or disseminate a court proceeding, the trial court must give reasonable notice to all parties to the proceeding and all witnesses. For court proceedings to be routinely recorded and disseminated, reasonable notice requires posting on the trial court's official webpage, the clerk's webpage, and the Office of Court Administration's webpage and on the door of the courtroom a general notice stating the types of proceedings and the nature of such coverage. For a proceeding that does not fall within the types of proceedings routinely recorded and disseminated by the trial court, reasonable notice requires specific notice to each party and witness.

Option1: (c) Any party or witness may object to the proceeding being recorded or disseminated at any time, even after the court proceeding has begun. A trial court may not record or disseminate the portion of a proceeding objected to by a party. A trial court may not record or disseminate the testimony of a witness over the witness's objection.

Option 2: (c) Any party or witness may object to the proceeding being recorded or disseminated at any time, even after the court proceeding has begun. The trial court must consider and rule on the objection, but is not required to conduct a separate hearing.

18c.4. Recording and Disseminating Court Proceedings by Any Person Other than the Trial Court:

(a) **Request to Cover Court Proceeding**. A person, other than the trial court, who wishes to record or disseminate all or any part of a court proceeding must file with the court clerk a request to do so at least 3 or [7] business days before the court proceeding. The request must state:

(1) the case style and number;
(2) the date when the proceeding is scheduled to begin:
(3) the name of the requesting person or organization;
(4) the type of recording, the type of disseminating, and the portions of the proceeding requested;
(5) how the proceeding will be recorded and disseminated;
(6) why the additional coverage is requested;
(7) the manner of recording and disseminating; and
(8) that all parties were notified of the request.

(b) **Notice and Opportunity to Object**. The trial court must give all parties and witnesses the opportunity to object. Witnesses may object only to their own testimony being recorded or disseminated.

(c) **Response to Request.** Any interested person may file a response to the request. If the interested person objects to the request the objection must not be conclusory.

(d) **Hearing**. The requestor, any party, or any interested person may request a hearing on objections to recording or disseminating a proceeding. The court may hold a hearing on objections, so long as the hearing will not substantially delay the proceeding or cause undue prejudice to any party or participant.

18c.5 Decision of the Court. In making any decision to record or disseminate court proceedings, or to permit such coverage, in whole or in part, the court shall consider all relevant factors, including but not limited to:

(1) the importance of maintaining public trust and confidence in the judicial system;
(2) the importance of promoting public access to the judicial system;
(3) whether public access to the proceeding is available absent the recording or disseminating of the proceeding;
(4) the type of case involved;
(5) the nature, importance, and degree of public interest in the court proceeding;
(6) whether the recording or disseminating would harm any participants;
(7) whether trade secrets, confidential, privileged or other proprietary information will be unduly disseminated;
(8) whether the recording or disseminating would interfere with the fair administration of justice, provision of a fair trial, or the rights of the parties;
(9) whether the recording or disseminating would interfere with any law enforcement activity;

(10) the objections of any of the parties, prospective witnesses, victims, or other participants in the proceeding of which coverage is sought;

(11) the physical structure of the courtroom and the likelihood that any equipment required to conduct recording or disseminating of proceedings can be installed and operated without disturbance to those proceedings or any other proceedings in the courthouse;

(12) the extent to which the recording or disseminating would be barred by other law or exclusionary rule;;

(13) undue administrative or financial burden to the court or participants;

(14) the fact that any party, prospective witness, victim, or other participant in the proceeding is a child;

(15) whether the proceedings would involve obscene matters;

(16) whether witnesses have been placed under The Rule (TCRP 267 and TRE 614);

(17) privacy interests of any persons, whether or not parties, witnesses or other participants in the proceeding, the potential for harm to such persons, and the ability or inability of such persons to protect themselves against harm resulting from the actions of others who may redisseminate the recording and alter it; and

(18) the chilling effect if the proceeding is recorded or disseminated on parties deciding whether to avail themselves of the legal system to bring or defend such matters, on potential witnesses' willingness to testify, or on the testimony that may be provided.

18c.6 Restrictions Recording and disseminating is prohibited in all cases, and these prohibitions cannot be waived by agreement of the parties, for the following:

(1) *Minor*s who are witnesses, parties, or victims;

(2) *Voir dire examination [clarify];*

(3) *Jurors;*

(4) *Conferences with Counsel*. Recording or disseminating of conferences, which occur in a court proceeding between attorneys and their clients, between co-counsel of a client, or between counsel and the judge; and

(5) *Closed proceedings, suppression hearings, and offers of proof or other proceedings which are otherwise closed to the public or to a jury.*

18c.7. Official Record. Any recording of a proceeding pursuant to these rules shall not be considered as part of the official court record.

18c.8 Violations of the Rule Any person who records or disseminates a court proceeding without approval in accordance with this rule may be subject to disciplinary action by the court, including contempt.

Tab L

Recording and Disseminating Court Proceedings

18 c.1 Definitions of Recording and Disseminating Recording of Court Proceedings

(a) **Recording:** using a device to capture the sound or image of any aspect of a court proceeding.

(b**) Disseminating:** conveying or transferring a recording of any aspect of a court proceeding;

(c) “Recording” and “disseminating” under this rule does not prohibit participants appearing remotely under Rule 21d or recordings made by the trial court to assist in the preparation of the reporter’s record.

18 c.2 Limits On Recording and Disseminating of Court Proceedings

Except for investitures or other ceremonial proceedings, which may be recorded, and disseminated at the trial court’s sole discretion, a trial court may only permit court proceedings to be recorded or disseminated in accordance with this rule and any standards adopted by the Texas Supreme Court.

18 c.3 Trial Court Recording and Disseminating of Court Proceedings

(a) A trial court may not record or disseminate court proceedings using any medium other than one approved [and provided] by the Office of Court Administration. All such recordings and disseminating of court proceedings by the trial court are the property of the State of Texas, not the property of the trial court or the parties to or witnesses in the case.

(b) In order to record or disseminate a court proceeding, the trial court must give reasonable notice to all parties to the proceeding and all witnesses. For court proceedings to be routinely recorded and disseminated, reasonable notice requires posting on the trial court’s official webpage, the clerk’s webpage, and the Office of Court Administration’s webpage and on the door of the courtroom a general notice stating the types of proceedings and the nature of such coverage. For a proceeding that does not fall within the types of proceedings routinely recorded and disseminated by the trial court, reasonable notice requires specific notice to each party and witness.

(c) Any party or witness may object to the proceeding being recorded or disseminated at any time, even after the court proceeding has begun. A trial court may not record or disseminate the portion of a proceeding objected to by a party. A trial court may not record or disseminate the testimony of a witness over the witness’s objection.

18c.4. Recording and Disseminating Court Proceedings by Any Person Other than the Trial Court:

(a) **Request to Cover Court Proceeding**. A person, other than the trial court, who wishes to record or disseminate all or any part of a court proceeding must file with the court clerk a request to do so at least 3 or [7] business days before the court proceeding. The request must state:

(1) the case style and number;
(2) the date when the proceeding is scheduled to begin:
(3) the name of the requesting person or organization;
(4) the type of recording, the type of disseminating, and the portions of the proceeding requested;
(5) how the proceeding will be recorded and disseminated;
(6) why the additional coverage is requested;
(7) the manner of recording and disseminating; and
(8) that all parties were notified of the request.

(b) **Consent Required** A trial court may permit the recording or disseminating of court proceedings when recording and disseminating the court proceeding will not unduly distract participants or impair the dignity of the proceedings, and the parties have consented, and consent to being recorded is obtained from each witness whose testimony will be recorded or disseminated.

18c.5 Restrictions Recording and disseminating is prohibited in all cases, and these prohibitions cannot be waived by agreement of the parties for the following:

(1) *Minor*s who are witnesses, parties, or victims;

(2) *Jury selection;*

(3) *Jurors;*

(4) *Conferences with Counsel*. Recording or disseminating of conferences, which occur in a court proceeding between attorneys and their clients, between co-counsel of a client, or between counsel and the judge; and

(5) *Closed proceedings, suppression hearings, and offers of proof or other proceedings which are otherwise closed to the public or to a jury.*

18c.6. Official Record. Any recording of a proceeding pursuant to these rules shall not be considered as part of the official court record.

18c.7 Violations of the Rule Any person who records or disseminates a court proceeding without approval in accordance with this rule may be subject to disciplinary action by the court, including contempt.

Tab M

MEMORANDUM

TO: Richard Orsinger, Chair of SCAC Subcommittee on Rules 15-165A
Judge Ana Estevez, 251st District Court of Potter County, Texas

FROM: Executive Committee, Family Law Council

SUBJECT: Proposed Rule Changes by the Texas Supreme Court

DATE: August 6, 2024

I
SUMMARY

The Supreme Court has asked the Supreme Court Advisory Committee (SCAC) to examine existing court rules and suggest recommendations on several proposed changes to the Texas Rules of Civil Procedure, Texas Rules of Appellate Procedure, Texas Rules of Evidence, and State Bar Court Rules. At the request of Richard Orsinger, Chair of the SCAC Subcommittee on Rules 15-165a, the Family Law Council reviewed all matters to be addressed by the SCAC Subcommittee and provides comments on two of the matters as specifically identified below.

II
COMMENTS

1. **Recording and Broadcasting Court Proceedings**
   a. *See attached Memorandum on Rule 18c*
2. **Transfer on Death Deed Forms**
   a. The Family Law Council provides no comments on this issue.
3. **Artificial Intelligence**
   a. *See attached Memorandum on Artificial Intelligence*
4. **Third-Party Litigation Funding**
   a. The Family Law Council provides no comments on this issue.
5. **Error Preservation Citation**
   a. The Family Law Council provides no comments on this issue.
6. **Texas Rule of Appellate Procedure 18.1**
   a. The Family Law Council provides no comments on this issue.
7. **Texas Rules of Civil Procedure 4**
   a. The Family Law Council provides no comments on this issue.
8. **Texas Rules of Evidence**
   a. The Family Law Council provides no comments on this issue.
9. **Court of Appeals Opinions**
   a. The Family Law Council provides no comments on this issue.

Tab N

MEMORANDUM

TO: Richard Orsinger, Chair of SCAC Subcommittee on Rules 15-165A
Judge Ana Estevez, 251st District Court of Potter County, Texas

FROM: Executive Committee, Family Law Council

SUBJECT: Proposed Rule Changes to Texas Rules of Civil Procedure 18C

DATE: August 6, 2024

I
SUMMARY

The Texas Supreme Court is charged with addressing changes to the Texas Rules of Civil Procedure 18c. It has asked the Supreme Court Advisory Committee (SCAC) to examine the existing rule and suggest recommendations. At the request of Richard Orsinger, Chair of the SCAC Subcommittee on Rules 15-165a, the Family Law Council has reviewed this matter and provides the comments in this Memorandum for the benefit of his committee and SCAC as a whole.

As noted by Chief Justice Hecht in his referral letter to SCAC,[1] the Committee previously discussed changes to TRCP 18c in 2022. Those proposed changes were part of the proposals submitted to the Texas Supreme Court by the Remote Proceedings Task Force.[2] Much has changed since the first iteration of the proposed TRCP 18c considered by SCAC was conceived and crafted. Now that Texas courts have emerged from the lockdown, the changes to TRCP 18c should reflect the future of court proceedings in a post-Covid environment, rather than addressing concerns specific to fully remote court proceedings from the "locked-down" pandemic era. We believe that, in order to function effectively, the rules should be adapted to encompass and apply equally to fully remote, hybrid, and in-person proceedings.

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[1] See letter from Chief Justice Nathan L. Hecht dated July 17, 2024.

[2] See Subcommittee 1's Report and Recommendations, November 9, 2021.

II
COMMENTS

Constitutional Open Court Requirement

Of great concern when remote proceedings were first implemented by Emergency Order in March of 2020 was how to comply with Constitutional open courts requirements. Courts must ensure and accommodate meaningful and unfettered public access to court proceedings. However, although constitutional in nature and origin, the right to public and open hearings is not absolute, and may be outweighed by other competing rights or interests, including promoting security, preventing disclosure of private information, ensuring a fair trial, and protecting a child from emotional harm. Limiting visibility or accessibility of live streamed proceedings implicates serious considerations and may constitute structural error requiring "automatic reversal and the grant of a new trial."[3] Both the Court of Criminal Appeals and the Texas Supreme Court have addressed remote proceedings in rulings over the last several years. To avoid problems, rules must be carefully formed so as to not permit courts to violate the public right of access to open court proceedings.

Remote Proceedings, In-Person Proceedings and Hybrid Proceedings

The current version of TRCP 18c was adopted by the Texas Supreme Court in 1990 and is clearly in need of revision to bring the rule into conformity with the reality of court proceedings following the pandemic. The changes to TRCP 18c that were reviewed by SCAC in 2022 do not differentiate between (1) court recording of remote proceedings, (2) court recordings of in-person or hybrid proceedings, (3) a court's live-streaming of proceedings for compliance with open court requirements, (4) a court's livestreaming of in-person proceedings when not required for open court compliance, (5) third-party recording of court proceedings, and (6) third-party livestreaming of court proceedings.

We strongly believe that Rule 18c should be split into separate and discrete categories for discussion and consideration in order to be most effective and to avoid confusion and problems. Key issues and concerns differ for each of these categories of digital recording. For example, when public access is available in the physical courthouse, certain testimony may be excluded from broadcast without constitutional or open courts implications. However, if the livestream is the only means of public access, the same exclusion may create structural and reversible error. We suggest that there may need to be separate and carefully crafted rules for live-streaming by a court in order to meet

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[3] For a broader discussion of open courts requirements, see "Background and Legal Standards – Public Right to Access to Remote Hearings during COVID-19 Pandemic," Office of Court Administration, May, 2020.

constitutional open courts requirements, and recording/streaming/broadcast of in-person or hybrid proceedings by press or non-court personnel. Modification of the rules must not unintentionally cause conflicting requirements for in-person broadcast versus streamed remote-proceedings, but the issues and priorities are significantly different.

Publication of Sensitive Information

Public broadcast and livestream of court proceedings should be carefully crafted to protect court participants. Once recordings are posted on or streamed to the Internet, they take on a life of their own and cannot be controlled in any way. Rule 18c.3 as currently proposed lacks sufficient protections for family law and child welfare cases, including ensuring the safety and welfare of children, and preserving and protecting extremely sensitive images and information, financial/identifying information in divorce cases, and medical, psychiatric, and psychological information. There are also no restrictions on broadcast of jurors' faces or identities. Without such protections, court participants and children may suffer long term trauma and financial consequences. This concern should be of paramount importance in addressing live-streaming requirements of family law cases. Due to the potential conflict with open-courts requirements, careful consideration must be given.

There is a market on social media and YouTube that provides live commentary on broadcast streams of judicial proceedings, and these shows are uncontrolled and uncensored. Live public commentary on court proceedings could chill testimony of reluctant witnesses and interfere with the court's ability to render just decisions. Child welfare and family law cases often include allegations and evidence of child abuse, mental health diagnoses, and drug usage. Broadcasting the testimony and photographic medical records of a Sex Assault Nurse Examiner could publicly humiliate and revictimize crime and abuse victims. Broadcasting personally identifying information such as full names and addresses on the internet creates significant security risks, especially in suits involving allegations (founded or unfounded) of family violence, abuse, or neglect. Broadcasting private financial records of parties and children could leave them exposed to risks of future financial and physical harm. Given the significant threat of online abuse, and the potential conflict of restricting public access to sensitive information with open-courts requirements, careful attention must be given to all factors and consequences before any rule amendment is promulgated.

Monetization of Broadcasting by Lawyers and Judges

The Judicial Code of Conduct prohibits judges from reaping financial benefit from their titles or jobs. Canon 2.B. states that, "[a] judge shall not lend the prestige of judicial office to advance the private interests of the judge or others[.]" We believe this Canon encompasses all forms of financial benefit that may be derived from broadcast or streaming of court proceedings, and as such there is no need for new rules regarding monetization of streaming or broadcasting. If clarification is desired to remove all doubt, we suggest that a comment could be added under Canon 2.B making clear that it applies to such avenues of financial benefit. We take no position on the ability of the Court to limit attorney use and monetization of such streams and recordings. Research and study is needed to assess the risks, dangers, impacts, and enforceability of such a rule.

Live Stream Commentary

We are aware of reports that a few judges permitted live chat and commentary on their livestreams, and even engaged with viewers or audience members by responding to their comments during livestreamed court proceedings. We believe that this sort of conduct is encompassed within and prohibited by existing Canons of the Judicial Code of Conduct, but do not oppose a specific rule that prohibits the live-streaming platform from permitting commenting or live-chat to take place.

Retention Policies

We do not believe that a specific rule on retention or mandatory destruction by courts of nonpublic video recordings of remote or livestreamed proceedings would necessarily improve the system. Retention policies are unique to each specific court. In the absence of a state-wide retention policy that applies to all judicial records including emails, audio recordings, Zoom recordings, court reporter recordings, security recordings, voicemails, or written communications, carving out video or audio recordings of live streams would cause confusion. If such a system is to be considered, it should be researched and thoroughly vetted prior to implementation.

Currently, recordings of streamed or recorded court proceedings are excluded from disclosure or production as "judicial records" under Rule of Court Administration 12. However, we agree that Rule 12 should be amended to clearly state that such recordings are not judicial records.

There are concerns regarding the long-term posting of court proceedings online by courts (such as leaving such recordings posted on the court's YouTube channel after a hearing is concluded). **We believe that a rule providing that the court's recordings of virtual, live-streamed, or broadcast court proceedings should not be maintained in a publicly-available format after conclusion of a hearing would benefit the system and would help avoid the noted concerns.** It is worth noting that this rule could not constrain the use of third-party or press recordings permitted under what is currently titled Rule 18c.3, which would not be subject to the court's control.

Any state-wide retention policy would affect county budgets significantly. A study of the effect of any such policy should be required before the policy is proposed or implemented.

III
CONCLUSION

The draft of proposed changes to TRCP 18c considered by SCAC in 2022 was the result of a year-long effort by the Remote Proceedings Task Force, which submitted its final report to the Texas Supreme Court in November of 2021. The Task Force's recommendations were then referred by the Supreme Court to SCAC, which discussed the proposals at length over the course of 2022. Much has changed in the time since the proposed revisions to TRCP 18c were first introduced. The task of revising TRCP 18c should not be rushed. Sufficient time should be spent to identify and evaluate all relevant concerns and strike a balance between the compelling and competing interests involved.

Tab N1

UNITED STATES DISTRICT COURT
DISTRICT OF COLUMBIA

IN RE MEDIA APPLICATION FOR AUDIOVISUAL ACCESS TO TRIAL PROCEEDINGS IN UNITED STATES OF AMERICA V. DONALD J. TRUMP	**Case No. 23-mc-99 (TSC)**
IN RE APPLICATION OF NBCUNIVERSAL MEDIA, LLC TO PERMIT VIDEO AND AUDIO OF TRIAL PROCEEDINGS IN UNITED STATES V. DONALD TRUMP	**Case No. 23-mc-107 (TSC)**

UNITED STATES' OPPOSITION TO APPLICATIONS TO BROADCAST THE CRIMINAL TRIAL OF UNITED STATES V. TRUMP

INTRODUCTION

A coalition of media organizations ("Media Coalition") and NBCUniversal Media ("NBCU") (collectively "Applicants"), seek permission to record and telecast, by various alternative means, the criminal trial of former President Donald J. Trump. The relief the Applicants seek is clearly foreclosed under Rule 53 of the Federal Rules of Criminal Procedure and Local Criminal Rule 53.1.1. Courts have long upheld Rule 53's constitutionality, and the Applicants provide no reasoned basis for a different result here. Whatever policy the Applicants believe supports their requested relief is not properly directed to the Court. And in any event, the Judicial Conference, which formulates policy for the federal courts, has long rejected the policy prescription the Applicants advocate, including as recently as September 2023. This Court should deny the Applications.

STATEMENT

1. Factual background

Under Rule 53 of the Federal Rules of Criminal Procedure, a "court must not permit the taking of photographs in the courtroom during judicial proceedings or the broadcasting of judicial proceedings from the courtroom" unless a statute or other Rule provides otherwise. Fed. R. Crim. P. 53. Local Rule 53.1.1 expands on Rule 53's broadcast prohibition, stating that:

> The taking of photographs and operation of tape recorders inside the United States Courthouse and radio and television broadcasting from inside the courthouse during progress of or in connection with judicial proceedings, including proceedings before a United States Magistrate Judge, whether or not court is actually in session, are prohibited. A judge may, however, permit (1) the use of electronic or photographic means for the presentation of evidence or the perpetuation of a record, and (2) the broadcasting, televising, recording, or photographing of investiture, ceremonial, or naturalization proceedings. Contents of official tapes that are made as part of the official record in a case will be treated in the same manner as official stenographic notes.

Loc. Crim. R. 53.1. Like all Federal Rules, Rule 53 binds the federal courts once enacted. *See Bank of Nova Scotia v. United States*, 487 U.S. 250, 255 (1988) (holding that federal rules are "in every pertinent respect, as binding as any statute duly enacted by Congress, and federal courts have no more discretion to disregard [a] Rule's mandate than they do to disregard constitutional or statutory provisions").

Since its original adoption in 1946, Rule 53 has expressly prohibited the broadcasting of criminal trials in federal court. In 1972, the Judicial Conference[1] went a step further by prohibiting

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[1] The Judicial Conference is the policy-making arm of the federal court system. *See generally Governance & the Judicial Conference*, Admin. Off. of the U.S. Cts., https://perma.cc/TW45-PT6S. Under the Rules Enabling Act, 28 U.S.C. §§ 2072-2077, the Judicial Conference authorizes the appointment of a Standing Committee on Rules of Practice and Procedure, which advises the Judicial Conference with respect to rulemaking. Separate advisory committees on the civil, criminal, appellate, evidence and bankruptcy rules report to and advise the Standing Committee. *See How the Rulemaking Process Works*, Admin. Off. of the U.S. Cts., https://perma.cc/CVU6-3VC9; *see also* 28 U.S.C. § 2073(a)(1) ("The Judicial Conference shall

"broadcasting, televising, recording or taking photographs in the courtroom and areas immediately adjacent thereto." *See History of Cameras, Broadcasting, and Remote Public Access in Courts*, Admin. Off. Of the U.S. Cts., https://perma.cc/C422-UPZX ("*History of Cameras in Courts*"). This prohibition was included in the Code of Judicial Conduct for United States federal Judges and applied to both criminal and civil cases.

In 1988, Chief Justice Rehnquist created an Ad Hoc Committee on Cameras in the Courtroom to study the issue. *See id.* The Ad Hoc Committee recommended a pilot program to permit electronic media coverage of civil proceedings in six district and two appellate courts. *Id.* In 1990, the Judicial Conference adopted the report, and struck the prohibition on broadcasting from the Judicial Code of Conduct. *Id.* In its place, the Conference adopted a policy that continued to prohibit the broadcasting of federal proceedings but made an exception to permit courts to allow broadcasting during "investitive, naturalization, or other ceremonial proceedings." *Id.* As for other proceedings, broadcasting was permitted only for limited internal court purposes, and in accordance with pilot programs approved by the Judicial Conference. *Id.*

The pilot program recommended by the Ad Hoc Committee and adopted by the Judicial Conference lasted three and a half years, from July 1, 1991, to December 31, 1994. *Id.* Based on the pilot project, the Committee on Court Administration and Case Management ("CACM") recommended to the Judicial Conference at its September 1994 meeting that it permit broadcasting of civil proceedings in both the trial and appellate courts. *Id.* The Conference concluded, however, that the intimidating effect of cameras on some witnesses and jurors remained a concern, and it declined to adopt the CACM recommendation. *Id.* Similarly, the Conference declined to approve a proposed amendment to Criminal Rule 53. *Id.*

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prescribe and publish the procedures for the consideration of proposed rules under this section.")

No significant changes happened over the next 25 years. In March 1996, the Judicial Conference amended its policy to permit the broadcasting of appellate arguments, subject to any restrictions in statutes, national and local rules, and Judicial Conference policy. *Id.* But the Judicial Conference remained opposed to the broadcasting of district court proceedings. In 2002, Rule 53 was amended as part of the restyling of the Federal Rules of Criminal Procedure, and changes were intended to be stylistic only. The Advisory Committee Note explained that the word "radio" was also removed from the rule, but "the Committee does not believe that the amendment is a substantive change but rather one that accords with judicial interpretation applying the current rule to other forms of broadcasting and functionally equivalent means." Fed. R. Crim. P. 53, Advisory Committee Note, 2002 Amendments. In 2010, the Judicial Conference authorized another pilot project to evaluate the effect of broadcast on district court proceedings. *See History of Cameras in the Courts*, *supra*. Fourteen districts participated in the pilot project, which ended in July 2015. *Id.* In March 2016, the Judicial Conference agreed to continue the pilot project in additional districts to gather more data but did not adopt any change to the broadcast policy. *See id.*

The pandemic brought about some changes to the broadcast policy. In March 2020, pursuant to Coronavirus Aid, Relief, and Economic Security (CARES) Act, 15 U.S.C. § 15002(b)(1), the Judicial Conference approved a temporary exception to permit judges to use teleconference technology to provide access to some judicial proceedings while public access to courthouses were restricted due to the COVID-19 pandemic. The exception ended on September 21, 2023. *See Judiciary Ends COVID Emergency; Study of Broadcast Policy Continues*, Admin. Off. of the U.S. Cts., https://perma.cc/2CNC-ZH32.

On September 22, 2023, the Judicial Conference adopted a new broadcast policy that, for criminal matters, effectively returned to the status quo before the pandemic. Although the policy permits a judge presiding over a civil or bankruptcy proceeding to authorize remote audio access to any part of the proceeding in which a witness is not testifying, that policy does not apply to criminal cases. In the criminal context, the Judicial Conference policy remains that embodied in Criminal Rule 53. *See Judicial Conference Revises Policy to Expand Remote Access Over Its Pre-COVID Policy*, Admin. Off. of the U.S. Cts., https://perma.cc/S35N-P6GP ("*Judicial Conference Revises Policy*"). And in all cases, Judicial Conference policy prohibits the broadcasting of witness testimony of any kind. *Guide to Judiciary Policy*, Vol. 10, ch. 4 § 410.10 (Judicial Conference policy "does not allow either civil or criminal courtroom proceedings in the district courts to be broadcast, televised, recorded, or photographed for the purpose of public dissemination").

2. **Procedural background**

A grand jury charged former President Trump in a four-count indictment. *See United States v. Trump*, 23-cr-257, ECF No. 1 (D.D.C Aug. 1, 2023). This Court set a trial date for March 4, 2024. Pretrial Order, ECF No. 39, *United States v. Trump*.

On October 5, 2023, the Media Coalition filed an application for Audiovisual Access to Criminal Trial Proceedings. *See In re Media Application for Audiovisual Access to Trial Proceedings in United States v. Trump*, Case No. 23-mc-99 (TSC), Application, ECF No. 1 ("Media Coalition App."). On October 11, 2023, NBCU filed a separate application seeking similar relief. *See In re Application of NBCUniversal Media, LLC to Permit Video and Audio of Trial Proceedings in United States v. Trump*, Case No. 23-mc-107 (TSC), Application, ECF No. 1 ("NBCU App."). On October 24, 2023, the Court consolidated the cases and entered a briefing schedule, which required the Government to respond on November 3, 2023; the Court further ordered the former President to file any response to the applications by November 10, 2023.[2] Minute Order of Oct. 27, 2023, *United States v. Trump*.

ARGUMENT

I. RULE 53 PROHIBITS THE RELIEF APPLICANTS SEEK

Rule 53's prohibition on "the taking of photographs in the courtroom during judicial proceedings or the broadcasting of judicial proceedings from the courtroom," Fed. R. Crim. P. 53, conclusively undermines the Applicants' request. *See Carlisle v. United States*, 517 U.S. 416, 426 (1996) ("[F]ederal courts have no more discretion to disregard [a Federal] Rule's mandate than they do to disregard constitutional or statutory provisions" (citation omitted)). The Court need proceed no further than Rule 53's plain language, as the Media Coalition acknowledges. *See* Media Coalition App. 2 (observing that Rule 53 and Local Rule 53.1.1 "on their face, create a per se prohibition on the broadcast of criminal proceedings to those unable to attend in person").

The counterargument that NBCU advances (NBCU App. 7) finds no support in the plain language of the rule, common sense, or sound policy. NCBU contends that Rule 53 does not prohibit using a single pool camera to transmit video of the trial to a studio, and from there to the public because Rule 53 refers only to "broadcast[s] . . . from the courtroom," which NCBU argues would not encompass the transmission of video to a studio and then from the studio to the broader public. That nonintuitive interpretation fails for multiple reasons. As an initial matter, NBCU defines the word "broadcast" to mean only direct transmission to a large group of people, *see* NBCU App, 6, but the term broadcast has other, more common definitions that are a better fit with

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[2] Counsel for former President Trump has requested that government counsel convey that he takes no position with respect to these Applications.

Rule 53. *See, e.g.*, Webster's New Collegiate Dictionary (defining "broadcast" to mean, *inter alia*, "the act of transmitting sound or images by radio or television"). NBCU's interpretation is nothing more than an attempt to "rewrit[e] or finesse[]" Rule 53 "through technical hairsplitting." *United States v. Moussaoui*, 205 F.R.D. 183, 184 (E.D. Va. 2002); *see also In re Sony BMG Music Entertainment et al.*, 564 F.3d 1, 9 (1st Cir. 2009) (denying petition to webcast civil trial because the intention of judicial policy is clearly to forbid all broadcasting with only certain enumerated exceptions). But even accepting NBCU's narrow definition of "broadcast," its proposal is still squarely foreclosed. NBCU's avowed intent is to undertake precisely what Rule 53 prohibits: placing a camera in the courtroom to record judicial proceedings occurring there and then broadcasting them to the public. That such transmission may make other stops along the way does not alter the fundamental fact that NBCU would be "broadcasting judicial proceedings from the courtroom." Fed. R. of Crim. P. 53.

That straightforward reading of Rule 53's plain text finds support in Judicial Conference policy. That policy "does not allow either civil or criminal courtroom proceedings in the district courts *to be broadcast, televised, recorded, or photographed for the purpose of public dissemination*." *See United States v. Google LLC*, No. 20-cv-3010, 2023 WL 6291644, at *1 (D.D.C. Sept. 8, 2023) (emphasis added) (quoting Guide to Judiciary Policy, Vol. 10, ch.4 § 410.10) (denying request to make available a publicly accessible audio feed because "[t]he governing rules compel that result"). Nor, as the Applicants suggest, is that policy outdated. *See* NBCU App. 9 (citation omitted). As recently as September 12, 2023, the Judicial Conference reiterated that its broadcast policy with respect to criminal cases remains the same—no part of a criminal trial may be broadcasted or recorded. The reasons for that policy choice were not due to "cumbersome equipment" or "distracting lighting," NBCU App. 9, but because, among other considerations, remote broadcast "could increase the potential for witness intimidation or complicate witness sequestration—vital considerations in ensuring trial proceedings are fair to all parties." *See Judicial Conference Revises Policy*, *supra*.

Neither of NBCU's two additional claims has merit. First, it claims that the Court should apply a "narrow" reading of the rule to avoid constitutional infirmity, but as discussed below, Rule 53 readily passes constitutional muster. Second, NBCU suggests that the Court Reporter Act, 28 U.S.C. § 753(b), provides a way around Rule 53 because the Court can use audiovisual recording as the official "record of proceedings," and then release the video to the public. But the Court Reporter Act simply provides that proceedings "shall be recorded verbatim by shorthand, mechanical means, electronic sound recording, or any other method, subject to regulations promulgated by the Judicial Conference and subject to the discretion and approval of the judge." 28 U.S.C. § 753(b). The purpose of the verbatim recording or transcription is for the court reporter to create the official record of the proceeding. Local Rule 53.1.1 expressly recognizes that recordings made for purposes of creating the official record are permitted. But those "official tapes that are made as part of the official record in a case will be treated in the same manner as official stenographic notes." Local Rule 53.1.1. Thus tapes, like pre-transcription notes, are not for public dissemination. *See Guide to Judiciary Policy*, *supra* (trial proceedings in the district courts may not "be broadcast, televised, recorded, or photographed for the purpose of public dissemination").

The decision in *United States v. McVeigh*, 931 F. Supp. 753 (D. Colo. 1996), is instructive. The court there had before it a motion from the news media to send directly to the press room the same audio feed of the trial that was being piped into the overflow courtroom (where no recording of the audio was permitted), so that the press could create their own recordings for public dissemination. The court had also originally permitted court reporters to sell audio tapes that were created as a redundant back-up system in the same way that reporters sell transcripts upon request. Upon reflection, however, the court concluded that this practice, and the reporters' request to record the audio feed themselves, violated Rule 53, as the redundant audio tapes were not themselves the official record; the official record was instead created by stenographic means. Thus, the court concluded "the ready access to the sound recordings has resulted in the functional equivalent of a [prohibited] broadcast of court proceedings." *McVeigh*, 931 F. Supp. at 755.[3] That sound interpretation parallels this District's local rules. *See* Loc. Crim. R. 53.1.1 (recordings made for record purposes are treated as stenographic notes and are not available to the public).

II. RULE 53 IS CONSTITUTIONAL AS APPLIED TO THE CRIMINAL TRIAL OF *UNITED STATES V. TRUMP*.

Applicants contend that even if Rule 53 precludes the relief they seek, the Rule is unconstitutional as applied to *United States v. Trump*. As an initial matter, Applicants' argument is premature. Applicants do not know at this juncture what arrangements will be in place at the courthouse to accommodate public and press attendance. Applicants decry that only a "few" members of the public, Media Coalition App. 17 n.23 (citation omitted), or a "miniscule" number of reporters and a "handful of members of the public," NBCU App. 3, will be able to observe the trial. But arrangements for the trial have not been announced, and as in most high-profile trials, procedures for overflow space and reserved places for the media are likely.[4] *See Moussaoui*, 205

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[3] Encompassing the "functional equivalent" of broadcasting within the Rule was in fact exactly what the Advisory Committee intended. When Rule 53 was amended in 2002 as part of a restyling project, the Advisory Committee noted that the word "radio" had been deleted from the rule. But, citing to *McVeigh*, it stated that "the Committee does not believe that the amendment is a substantive change but rather one that accords with judicial interpretation applying the current rule to other forms of broadcasting and functionally equivalent means." Fed. R. Crim P. 53, Advisory Committee Note, 2002 Amendments.

[4] Overflow courtrooms were provided, for example, to accommodate public interest in the

F.R.D. at 185 (rejecting argument that limited seating in a courthouse violates the rights of those who cannot attend). Instead, Applicants appear to argue that no accommodation that the courthouse can make by way of increased viewing capacity can satisfy the Constitution in this case. *See, e.g.,* Media Coalition App. 8–9, 8 n.8 (suggesting that "81.3 million victims" are entitled to attend the trial). But no law supports Applicants' theory, and every court to have considered the issue has concluded that there is no constitutional right to a televised trial.

A. At Most, Rule 53 Is a Content-Neutral Time, Place, and Manner Restriction that Is Fully Consistent with the First Amendment.

As an initial matter, a broadcast ban arguably does not burden speech or implicate the First Amendment in any way. *Rice v. Kempker*, 374 F.3d 675, 678-79 (8th Cir. 2004) ("Neither the public nor media has a First Amendment right to videotape, photograph, or make audio recordings of government proceedings that are by law open to the public"); *see also United States v. Edwards*, 785 F.2d 1293, 1295 (5th Cir. 1986); *Moussaoui*, 205 F.R.D. at 186. There is no dispute that the public, and by extension the press, has a constitutional right of access to criminal trials. *Richmond Newspapers, Inc. v. Virginia*, 448 U.S. 555, 579–80 (1980). But the right of access addressed by *Richmond Newspapers* and its progeny, and guaranteed by the Constitution, is the right to attend a criminal trial—not the right to broadcast it. *Id.* at 580. Moreover, no court, including *Richmond Newspapers*, has ever suggested that trials must accommodate every person interested in attending. The fact that the trial is open to the public and the media, which can "attend, listen and report" to the larger public, fully satisfies the constitutional right of access. *Edwards*, 785 F.2d at 1295. A restriction on broadcast, therefore, neither burdens speech nor rises to constitutional proportions.

The Supreme Court has repeatedly indicated that there is no First Amendment right to

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defendant's initial appearance in *United States v. Trump*.

broadcast a criminal trial. As the Court explained in *Estes v. Texas*, 381 U.S. 532 (1965), it is a "misconception of the rights of the press" to conclude that "the freedoms granted in the First Amendment extend a right to the news media to televise from the courtroom." *Id.* at 539; *see also id.* at 589 (Harlan, J., concurring) ("The rights to print and speak, over television as elsewhere, do not embody an independent right to bring the mechanical facilities of the broadcasting and printing industries into the courtroom"). Similarly, in *Nixon v. Warner Communications, Inc.,* 435 U.S. 589 (1978), the Court addressed whether the Constitution required that the press gain immediate physical access to the Nixon tapes, portions of which were played for the jury during trial. The press, as here (*see, e.g.*, NBCU App. 30), argued that publication of the tapes was essential to the public's understanding of one of the most high-profile trials in history, and that a transcript did not adequately allow for the public to make judgments based on inflection and emphasis. The Court rejected that argument, however, because "the same could be said of the testimony of a live witness, yet there is no constitutional right to have such testimony recorded and broadcast." *Nixon*, 435 U.S. at 610 (citing *Estes,* 381 U.S. at 539–542 (Harlan J. concurring)). Rule 53 is entirely consistent with the Supreme Court's repeated statements that there is no constitutional right to broadcast a judicial proceeding.

Even assuming otherwise, every court to have considered the constitutionality of broadcasting prohibitions on otherwise open trials has concluded that, to the extent they restrict speech at all, they are content-neutral time, place, and manner restrictions, fully consistent with the First Amendment. *See, e.g.*, *Conway v. United States*, 852 F.2d 187, 188 (6th Cir. 1988); *Edwards*, 785 F.2d at 1295–96; *United States v. Kerley*, 753 F.2d 617, 619–20 (7th Cir. 1985); *Westmoreland v. Columbia Broad. Sys., Inc.*, 752 F.2d 16 (2d Cir. 1984); *United States v. Yonkers Bd. of Educ.*, 747 F.2d 111, 113 (2d Cir. 1984); *United States v. Hastings*, 695 F.2d 1278, 1280

(11th Cir. 1983); *Moussaoui*, 205 F.R.D. at 183; *United States v. Shelnutt*, No. 09-cr-14, 2009 WL 3681827 (M.D. Ga. 2009); *Courtroom Television Network LLC v. New York*, 779 N.Y.S.2d 74 (N.Y. App. Div. 2004); *see also Rice*, 374 F.3d at 674.

Prohibiting cameras in the courtroom passes constitutional muster because the restriction on the manner of access is reasonable and promotes significant governmental interests. A content-neutral time, place, and manner restriction satisfies the First Amendment so long as it serves significant government interests, is narrowly tailored to those interests, and leaves open ample alternative channels for speech. *Tinius v. Choi*, 77 F.4th 691, 699 (D.C. Cir. 2023). Rule 53 readily meets that standard. First, the restriction on broadcast is neutral because it is unrelated to the underlying content. *See Ward v. Rock Against Racism*, 491 U.S. 781, 791–93 (1989). Second, the restriction promotes a compelling government interest in ensuring a fair trial. *See Estes* 381 U.S. at 540 ("We have always held that the atmosphere essential to the preservation of a fair trial—the most fundamental of all freedoms—must be maintained at all costs."); *Cox v. Louisiana*, 379 U.S. 559, 562 (1965) ("Since we are committed to a government of laws and not of men, it is of the utmost importance that the administration of justice be absolutely fair and orderly."). The interest in a fair trial in turn ensures critical subsidiary interests such as protecting the truth-finding function of the court, ensuring the preservation and value of live witness testimony, guarding against witness intimidation, and serving judicial efficiency and economy. On this score, the knowledge that cameras are present in the courtroom can affect witnesses, jurors, and attorneys in subtle ways. Not only will the participants be cognizant of being televised, but in today's world, a broadcast is not limited to television, and the recording exists not for a moment but, for all intents and purposes, indefinitely. *See Hastings*, 695 F. 2d at 1282–83; *Kerley*, 753 F.2d at 622 ("[K]nowledge of being televised might cause the judge, jurors, or witnesses to be distracted—

whether by embarrassment, self-consciousness, anxiety or desire to 'star'"); *see also Moussaoui*, 205 F.R.D. at 187 (describing difficulties cameras pose in trial management).

Third, the broadcasting prohibition in Rule 53 is narrowly tailored because it "promotes a substantial government interest that would be achieved less effectively absent the regulation." *Ward*, 491 U.S. at 799 (citation omitted). The choice is not between open or closed proceedings; criminal trials are open to the public. Rather, the broadcast restriction is narrowly tailored to avoid the risks that policymakers have determined cameras pose to the fair administration of justice. *See, e.g., Kerley*, 753 F.2d at 621. Finally, Rule 53 does not "unwarrantedly abridge . . . the opportunities for the communication of thought" in public places, *Cox v. New Hampshire*, 312 U.S. 569, 574 (1941), because reporters are free to attend the trial and report on what they observe, *Hastings*, 695 F.2d at 128. Accordingly, the First Amendment is fully satisfied.

Applicants recognize that governing authority is entirely against them. Media Coalition App. 19; NBCU App. 23. The Applicants' counterarguments—that the case law is stale, technology has changed, and the public interest in the upcoming trial is exceptional—lack merit.

There is no question that public interest in the upcoming trial is high. But the public interest was similarly high in other cases in which courts have rejected claims that the First Amendment requires a criminal trial to be broadcast. In *Hastings*, for example, the court faced the rare circumstance of a sitting federal judge being indicted and tried for conspiracy to solicit a bribe. 695 F. 2d at 1282–83. The Supreme Court in *Nixon v. Warner Communications* addressed Watergate and the Nixon tapes, an extraordinary chapter of American history. 435 U.S. at 591-94. And *United States v. Moussaoui* involved the criminal case of Zacarias Moussaoui, an Al-Qaeda member being tried for participating in the conspiracy to attack the United States on September 11, 2001. 205 F.R.D. at 188. That attack killed some 3000 people and altered the course of history in the United States and worldwide. *Id.* Yet, those courts found no constitutional infirmity when confronting the same arguments that the Applicants make here.[5] In *Moussaoui*, for example, the court concluded that despite the public interest, the inability of every interested member of the public to observe the trial through the media "does not raise a question of constitutional proportion." *Id.* at 186.

Nor is the case law stale and "pre-Internet." Media Coalition App. 19. In making this claim, Applicants rely on court of appeals cases from the 1980s, but they neglect to mention that courts within at least seven different circuits, over the course of 40-plus years, have all found that there is no constitutional right to have a trial broadcasted. *See supra* at 11–12. The Judicial Conference, moreover, just months ago reaffirmed its policy choice with respect to the broadcasting of trials after a long period of study. *See Judicial Conference Revises Policy*, *supra.*

Advances in technology do not diminish the government's significant interest in ensuring a fair trial. *See Kerley*, 753 F.2d at 622 ("That cameras may be smaller, lighter and quieter is not a change having constitutional significance."); *see also In re Sony BMG Music*, 564 F.3d at 9 (holding that despite changes in technology, there is no right to webcast a trial). To the contrary, advances in technology raise additional concerns. While today's technology may be less physically obtrusive in the courtroom, with fewer cables and lights, Media Coalition App. 15–16, modern technology poses an even greater threat to the fair administration of justice, *see Moussaoui,* 205 F.R.D. at 186–87 (finding that advances in technology have created new threats to the integrity of the factfinding process). Video not only airs on television but streams and remains on the internet effectively forever. *Moussaoui*, 205 F.R.D. at 187. When a witness's

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[5] Neither Applicant cites the *Moussaoui* decision, despite it addressing an exceptionally high- profile trial in which the court considered and rejected many of the same arguments that Applicants urge here.

image is captured on video, it is not just a fleeting image, but it exists indefinitely. *Id.* Paired with the ever-increasing acrimony in public discourse, witnesses and others who appear on video may be subjected to threats and harassment. Were there an appeal and retrial, witnesses who were subjected to scrutiny and harassment on social media may be unwilling to testify again. Even the knowledge that their images will circulate on social media may temper a witness's initial testimony. In addition, knowing that the trial will be broadcast in the first instance may make jurors unwilling to serve. Jurors who are seated may feel intimidated, even if efforts are made to conceal their faces. And knowing that a trial is being broadcast can lead to participants grandstanding for the cameras. *See generally id.* at 188 (cataloguing the harms that modern technology can cause to a trial, the sole purpose of which is "to determine the innocence or guilt of this defendant for the specific crimes charged in the Indictment"). Finally, whatever the merits of Applicants' argument that *United States v. Trump* is uniquely appropriate for audiovisual broadcast, the same dangers exist here, and possibly more so. Rule 53 is therefore appropriate as applied to this case.

B. No Authority Supports the Application of Strict Scrutiny.

NBCU's argument that that Rule 53 constitutes a content-based restriction on speech requiring strict scrutiny is flawed. It cites *Ness v. City of Bloomington,* 11 F.4th 914, 923 (8th Cir. 2021), but that case involved the issue of whether an ordinance that prohibited capturing the image of a child was subject to strict scrutiny. The court found that the ordinance was not content neutral because one would have to examine the content of the film to determine whether in fact it captured a child's image. By contrast, Rule 53 implicates no content at all; it merely restricts the manner of accessing a trial. *See Hastings*, 695 F.2d at 1282 (holding that Rule 53 does not bar the press or public from any part of trial, and thus strict scrutiny does not apply); *see also Ward*, 491 U.S.

781, 791 ("The principal inquiry in determining content neutrality . . . is whether the government has adopted a regulation of speech because of disagreement with the message it conveys.").

NBCU's arguments to the contrary are unavailing. First, treating video and print differently is not a content-based restriction. NBCU App. 19. As the court in *Moussaoui* explained,

> [T]hese various forms of media are only distinguished by the manner in which the information is delivered, conveyed and packaged to the public, not by the methods by which the news is gathered. Electronic media representatives are not excluded from the courtroom nor are they treated differently than members of the print media. . . . Rule 53 limits only the equipment members of the media are permitted to bring into the courtroom.

205 F.R.D. at 185–86; *accord Hastings*, 695 F. 2d at 1282.

Second, NBCU argues that broadcast prohibition is content based because "no such sweeping ban exists for civil proceedings and other courthouse activities." NBCU App. 19. But Judicial Conference policy prohibits broadcasting of all trial proceedings and witness testimony, in both civil and criminal cases. Ceremonial proceedings, such as investitures and naturalizations are ceremonies, not trials, and therefore do not implicate the government's compelling interest in ensuring a fair trial. It makes little sense to argue that allowing the broadcast of purely ceremonial events makes Rule 53 by comparison a content-based restriction on speech. Moreover, even if the Rules treated civil and criminal trials differently, that would not make Rule 53 unconstitutional. Policymakers are entitled to consider the differing stakes in a criminal trial and the societal interest in ensuring the solemnity of criminal proceedings where the accused may face loss of liberty. And civil and criminal trials are treated differently in many contexts, including in both the Constitution and in the Federal Rules. *See, e.g.*, U.S. Const. amend. VI (applicable only to criminal cases); *Baxter v. Palmigiano*, 425 U.S. 308, 318–19 (1976) (permitting the factfinder in civil cases—but not criminal cases—to draw adverse inferences from a defendant's invocation of the Fifth

Amendment privilege against self-incrimination); Fed. R. Evid. 404(b)(3) (requiring notice only in criminal cases).

Finally, NBCU contends that Rule 53 is a content-based restriction on speech because it seeks "to determine what speech is good for the public and what speech is bad." NBCU App. 21. This is inaccurate. Rule 53 does not in any way differentiate "good" from "bad" content; the upcoming criminal trial will be open to any member of the public and any type of reporter, print or broadcast. Rule 53 restricts only the manner in which the trial is transmitted to the broader public. *Kerley*, 753 F.2d at 620 (holding that "a *limitation* on the public access to a trial is not subject to the same 'strict scrutiny' given a denial of access"). At bottom, "the inability of every interested person to attend the trial in person or observe it through the surrogate of the media does not raise a question of constitutional proportion," let alone establish a content-based restriction triggering strict scrutiny. *Moussaoui*, 205 F.R.D at 186.

C. Whether Cameras Should Be Permitted in the Courtroom Is Ultimately a Policy Question.

Applicants contend the day has come to permit criminal trials to be broadcast. *See* Media Coalition App. 10–20; NBCU App. 23–32; Decl. of Rebecca Blumenstein; Decl. of Marc Greenstein. They posit that state courts have demonstrated that broadcasting does not degrade the integrity of the criminal justice process; that some academics and judges support it; that it was permitted during the recent pandemic allegedly without ill effect; that modern technology, in their view, makes the process non-disruptive; and that broadcasting would enhance public confidence in the proceedings, among other arguments. *Id.* But these are all policy arguments best left to legislators and rulemakers. *See Hastings*, 695 F.2d at 1284 (issue of cameras in the courtroom should be addressed to the appropriate rulemaking authority); *Kerley*, 753 F.2d at 622 (petitioner's arguments best directed at those who make the rules); *Moussaoui,* 205 F.R.D. at 186 (question is one of social and political policy best left to Congress and the Judicial Conference).

Here, the Judicial Conference—having studied the issue for decades—reaffirmed the policy of the federal courts in September 2023. Its policy judgment was to continue to prohibit the audio or video broadcasting of criminal trials. While Applicants are free to advocate their views to policymakers,[6] this Court should decline their invitation to ignore the binding nature of Federal Rule of Criminal Procedure 53. Accordingly, the Applications should be denied.

CONCLUSION

For all the reasons stated above, the Applications should be denied.

Dated: November 3, 2023

Respectfully submitted,

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[6] The Media Applicants have already written to the Advisory Committee on Criminal Rules requesting that the Committee consider an amendment to Rule 53 to either allow broadcasting in criminal trials, or to allow courts to grant exceptions to the rule for trials of extraordinary public interest. *See* Ltr. from Media Orgs. to Comm. on Rules of Prac. and Proc. (Oct. 5, 2023), *available at* https://perma.cc/XX39-AR6Y. At the October 26, 2023, meeting of the Advisory Committee, the Chair established a subcommittee to study the issue.

Tab O

Supreme Court of Texas Probate Forms Task Force
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Ms. Trish McAllister
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Osler McCarthy

February 2, 2024

Justice Brett Busby
The Supreme Court of Texas
Supreme Court Building
201 West 14th Street, Room 104
Austin, Texas 78701

RE: Report to the Supreme Court of Texas, Misc. Docket No. 16-9003

Dear Justice Busby and Justices of the Supreme Court of Texas:

As I believe the Court is aware, the Probate Forms Task Force has finally completed our assigned tasks with the forwarding of the enclosed Transfer on Death Deed (TODD) forms, related forms, and instructions. The Task Force members originally appointed by the Supreme Court on January 21, 2016 are Judge Polly Jackson Spencer as chair, Carlos Aguinaga, Barbara McComas Anderson, Julie Balovich, Craig Hopper, Cathy Horvath, Jerry Frank Jones, Judge Steve M. King, Trish McAllister, Christy Nisbett, and Arielle M. Prangner. Of our original group, Christy Nisbett retired. Julie Balovich and Cathy Horvath took different jobs but remained involved in this phase of our assignment to some degree. Judge King and Jerry Frank Jones were unable to participate in the work on these forms due to other commitments. We were privileged, though, to have Ronald Lipman, an attorney in Houston, working with us. As you know, he expressed a particular interest in working on these forms and has extensive experience in form preparation in general. We continued to meet almost monthly, primarily by Zoom, to work on this project. Our primary contact at the Texas Access to Justice Commission, Trish McAllister, also left to take another position, but she volunteered to continue to work with us. Her involvement was crucial to the completion of this task.

The process has continued to be interesting, challenging, and educational but also much more difficult and time-consuming than any of us anticipated. The Task Force consists of very detail-oriented people from different backgrounds – estate planning attorneys, Legal Aid attorneys, judges, and clerks – all of whom see problems relating to the use of these forms from different perspectives. We tried to accommodate the concerns raised by each member in drafting these forms as we have with our other forms. We believed, though, that our mandate was to write forms in "plain language" for people to complete without the assistance of an attorney.

Related to the point made in the preceding paragraph, I recently had a conversation with an attorney not from San Antonio where I live. She told me that she and her partner had been reviewing the will forms which the Task Force prepared and the Court put out last spring. She raised concerns about the use of these forms by lay people and the possibilities for various misunderstandings and mistakes – problems likely to require the assistance of attorneys, at some cost, to straighten out. She was surprised and chagrined about our conversation when I told her that I had been on the Task Force that prepared the forms. I assured her that those of us on the Task Force shared her concerns, but the task given to us was to prepare forms for lay people to use without requiring the assistance of an attorney. I mention this because it highlights the need for the work recently done by the Working Group on Access to Legal Services on which both Craig Hopper and I were privileged to serve, and the need for implementation of suggestions included in the Group's Report to the Texas Access to Justice Commission delivered on December 15, 2023.

We are pleased to present these forms to the Court as a product into which much time, thought, and effort has gone. We recognize that the forms will be reviewed and likely revised by the Court. We also recognize that no form will be perfect and that they will probably be revised from time to time as the public uses them and provides information about their ease of use and general value. I speak for all of us when I say we would like to discuss any revisions the Court makes. I know I speak for all of us when I say that it has been an honor for us to be asked to be a part of this important work and this task force.

Very truly yours,

Polly Jackson Spencer

Hon. Polly Jackson Spencer
Chair

INSTRUCTIONS AND FAQs
REVOCABLE TRANSFER ON DEATH DEED
FOR AN INDIVIDUAL OWNER

You can use this **Revocable Transfer on Death Deed** ("TODD") form to transfer ownership of real property located in Texas when you die without going to court. To sign a TODD, you must have the legal and mental capacity to sign a contract. The Transfer on Death Deed is authorized under Chapter 114 of the Texas Estates Code.

This TODD Set Contains four forms with frequently asked questions and instructions on how to complete the following forms: a Revocable Transfer on Death Deed for an Individual Owner, a Revocable Transfer on Death Deed for Married Owners or Two Co-Owners, a Cancellation of Revocable Transfer on Death Deed, and an Affidavit of Death.

Use this form if:

- You are an owner of real property located in Texas and want to transfer ownership of the property to someone else when you die without a court hearing being required.
- You already filed a TODD in the deed records in the County Clerk's office of the county where the property is located, and you want to create a new TODD to change who will receive the property on your death.

Use the TODD form for Married Owners or Two Co-Owners if:

- You own the property with another co-Owner and you both want to transfer your interest in the property to each other when you die.
- You are married, the real property is community property, and you both want to transfer your interest in the property to each other when you die.

Do not use this form if:

- You do not own an interest in the property. (However, it is okay to use this form if your interest in the property is subject to a mortgage.)

Consult an Attorney if:

- You are married and you do not want to transfer your interest in the property to your spouse. Your spouse may still have homestead rights in the property if you die first.

Helpful Words to Know:

- Community property: Real property is community property if it is acquired during your marriage, except for separate property acquired before or during the marriage.
- Separate property: Real property is separate property if you owned it before your marriage, received it during your marriage by gift or inheritance, or purchased it with separate property money.

The rules of community property and separate property are complicated. If you are not sure whether your property is community or separate property, contact a lawyer for advice.

NOTICE TO PROPERTY OWNERS: Carefully read all instructions for this form before completing and signing it. This form is designed to fit some but not all situations. If you have questions after reading these FAQs and instructions, you should contact a lawyer for advice. These instructions are not a substitute for the advice of an attorney.

For privacy and identity theft reasons, **do not** put your Social Security number or driver's license number on this form. They are not required.

A. FREQUENTLY ASKED QUESTIONS (FAQs)

1. What does a Transfer on Death Deed ("TODD") do?

A TODD transfers ownership of real property, including mineral interests, located in Texas to someone else when you die without going to court. It does not transfer any other kind of property, such as personal property (cars, cash, jewelry, etc.) or any real property located outside of Texas. If you want to use a TODD to transfer a mobile or manufactured home, see FAQ 9.

2. What does this Individual Owner Revocable TODD do?

The Individual Owner Revocable TODD form can be used to transfer ownership of real property to someone else when you die without going to court.

3. Who can I name as a beneficiary or alternate beneficiary in the Individual Owner Revocable TODD form?

You can name anyone you want as a beneficiary or alternate beneficiary, including a family member, a friend or other person, a charity, an educational institution, a trustee of a trust (including the trustee of a revocable or irrevocable trust), a custodian under the Uniform Transfers to Minors Act, etc. You must include the name and address of each person or entity you name as beneficiary or alternate beneficiary, so make sure you have this information when you prepare the form. You do not have to notify any beneficiary that you have named them in the form, but it is recommended that you do.

4. Does a TODD change my ownership of the property or my ownership rights before I die?

No. Even though you must file the TODD in the deed records before you die, you still own your interest in the property and retain your interest in the property rights until you die. This includes the right to use your interest in the property as collateral for a loan, obtain property tax exemptions on your interest, make repairs or other improvements, sell, or transfer your interest in the property as long as the sale or transfer complies with marital property or other co-owner rights, etc.

5. Can I use this Individual Owner Revocable TODD form if I'm married?

It depends.

<u>If you are married and want to name your spouse as the beneficiary</u>, you can use this form if:

- the property is your separate property and your spouse does not have any ownership interest in the property.
- the property is community property, or your spouse has an ownership interest in the property, and you want your interest in the property to transfer to your spouse when you die. If both spouses intend for the property to transfer to the surviving spouse when the first spouse dies, each spouse needs to sign a TODD form naming the other spouse as the beneficiary **or** you can use the TODD form and instructions for Married or Two Co-Owners instead.

If you are married and you want to name someone other than your spouse as the beneficiary, you should consult an attorney, even if the property is your separate property and your spouse has no ownership interest in it. If you create and file a TODD leaving your separate real property to someone other than your spouse, your spouse may still have homestead rights in the property if you die first.

6. What happens when I die?

As long as the TODD is filed in the deed records in the County Clerk's office of each county where the property is located before your death, the property transfers to the beneficiary or beneficiaries named in the TODD (or to their descendants, if this option is chosen) who survive you by at least 120 hours in the shares indicated in the TODD.

If all beneficiaries (and their descendants, if that option is chosen) are deceased or do not survive you by at least 120 hours, then the property transfers to the alternate beneficiaries named in the TODD (or to their descendants, if that option is chosen) in the shares indicated in the TODD.

7. What property can I transfer using a TODD?

A TODD only transfers real property located in Texas. You can only transfer the portion of the real property that you own. A TODD does not transfer any other kind of property, such as personal property (cars, cash, jewelry, etc.) or any real property located outside of Texas. If you want to use a TODD to transfer a mobile or manufactured home, see FAQ 9.

If you are married and you want to name someone other than your spouse as the beneficiary, you should consult an attorney, even if the property is your separate property and your spouse has no ownership interest in it. If you create and file a TODD leaving your separate real property to someone other than your spouse, your spouse may still have homestead rights in the property if you die first.

8. Can I transfer more than one piece of property in this TODD form?

This TODD form is designed to transfer one piece of real property. If you own more than one piece of real property in Texas and you want to transfer additional properties using a TODD form, you should complete and file a separate TODD form for each piece of property.

9. Can I use a TODD to transfer a mobile or manufactured home?

If you want to use a TODD to transfer a mobile or manufactured home, you must:

- Own the real property that the mobile or manufactured home is permanently attached to,
- Have a Statement of Ownership declaring that the mobile or manufactured home is a part of the real property, and
- That Statement of Ownership must have been filed in the deed records in the County Clerk's office of each county where the mobile or manufactured home is located.

For more information, see the Texas Department of Housing and Community Affairs website at https://www.tdhca.state.tx.us/mh/ownership-location.htm and the Application for a Statement of Ownership form at https://www.tdhca.state.tx.us/mh/docs/1037-applysol.pdf.

10. What if I have a Will that leaves the property to someone else?

A properly filed TODD overrules a Will. The property transfers to the beneficiary named in the TODD, not the person named in your Will. This is true even if you make a Will after you have completed and filed the TODD. If you already have a Will or plan to sign one, contact a lawyer for advice about the best method for transferring your real and personal property upon your death.

11. What do I do with the TODD after I fill it out and sign it?

Once you have completed the TODD and signed it in front of a Notary Public, you must file it in the deed records in the County Clerk's office of each county where the property is located. You may need to show the Notary Public a form of identification. You will have to pay a filing fee. Contact the County Clerk for more information. The County Clerk may file the TODD immediately and hand the original back to you, or the Clerk may mail the original TODD to the person you listed in the "After Recording, Return to:" box. Keep the original TODD in a safe place.

12. Does the beneficiary need to do anything to claim the property when I die?

After you die, an "Affidavit of Death" should be filed in the deed records in the County Clerk's office of each county where the TODD was filed. Filing the Affidavit of Death notifies the public that the property has transferred to the new owner or owners. The Affidavit of Death form included with this TODD form can be used at that time.

13. If I change my mind, how can I "undo" a TODD?

If you change your mind, you can revoke (cancel) a TODD at any time before you die either by creating a new TODD or by completing a Cancellation of TODD form. You cannot revoke a TODD by tearing it up once it's been filed. The new TODD or the Cancellation of TODD must be filed in the deed records in each County Clerk's office where you originally filed a TODD. There will be a filing fee.

NOTE: If you cancel your TODD or make a new one, it only affects the portion of the property that you own. It will not affect the ownership rights of any other co-owners.

14. What happens if I get divorced after I have filed this Individual Revocable TODD?

A TODD naming your spouse as beneficiary will remain in effect unless, before you die, a notice of the divorce judgment or a final decree of divorce is filed in the County Clerk's office in each county where the TODD was originally filed. A filed notice of the divorce judgment or final decree of divorce revokes (cancels) your ex-spouse as a beneficiary but does not change the alternate beneficiaries, such as your ex-spouse's children or relatives. A filed Cancellation of TODD or a new TODD will completely revoke the TODD.

You can get a notice of divorce judgment or a final decree of divorce from the clerk of the court where your divorce was finalized. Check with the County Clerk's office where you filed the TODD to see if you need a certified copy of a notice of divorce judgment or a final decree of divorce. If so, you will need to get a certified copy from the clerk of the court where your divorce was finalized, and a fee may be charged.

Because a notice of divorce judgment and a Cancellation of TODD are shorter than a divorce decree, they are significantly less expensive to file. A divorce decree may also include private information, such as the names of children or other private information, so it is best to use a notice of divorce judgment or a Cancellation of TODD.

15. **What if I owe debts on the property I want to transfer?**

    You can sign a TODD to transfer the property even if there is a debt or lien on the property, such as a mortgage. The property transfers to the beneficiary or beneficiaries when you die even if there are debts or liens on the property. A TODD does not protect the property from your creditors. Any mortgages, liens, homeowners' association fees, property taxes, homeowners' insurance, etc., will still need to be paid as required. The property could also be used to pay any other unpaid debts at your death or expenses related to your death. A title company or other party asked to rely on the TODD may request proof that there are no such outstanding debts or expenses, including taxes. If you have questions or concerns about this, consult an attorney.

16. **Will a TODD affect my Medicaid benefits?**

    No. It will not affect your Medicaid benefits because the property does not transfer until you die.

17. **What if there is a Medicaid Estate Recovery Program (MERP) claim against my estate after I die?**

    If the State wants to be repaid after you die for Medicaid benefits you received during your lifetime, property properly transferred under a TODD is not subject to a MERP claim under current law. If you have questions or concerns about this, consult an attorney.

B. COMPLETING THE REVOCABLE TRANSFER ON DEATH DEED FOR INDIVIDUAL OWNER FORM

1. **Owner**

   Enter the owner's full name exactly as it appears on your original property deed. If your name has changed, enter the name as shown on the deed followed by "AKA" (also known as) and your current name.

2. **The "Property" is:**

   Physical Address of the Property: Enter the physical address of the property, including the number, street name, city, county, state, and zip code.

   Legal Description of the Property: Print the legal description of the property, which is different from the mailing or physical address. Use the legal description exactly as it appears on your property deed. **It is very important that this information is correct**. If you do not have a copy of your property deed, you may request a copy from the County Clerk's office in the county where the property is located because it should have been filed there when you acquired the property. If you are not able to obtain a copy of your deed or are unsure of the legal description, you may want to consult an attorney.

   If you have no other alternative, you can use the property description listed on your property tax statement but be aware that it may not be correct or sufficient to transfer title of the property to the beneficiary or beneficiaries.

3. Beneficiary or Beneficiaries

Print the name of the beneficiary or beneficiaries you want to receive the property when you die. You can name up to four beneficiaries on this form. Use additional pages if you want to name more than four beneficiaries. *See* FAQ 3 for who or what can be listed as a beneficiary. If you name the trustee of a revocable or irrevocable trust, you should use a format similar to the following:

> "[Name of trustee], trustee of the [Name of trust] under trust agreement dated [Date]"

You should also enter the address of the trustee and also indicate that the relationship of this beneficiary is either "revocable trust" or "irrevocable trust" (whichever applies). Do not check the box indicating that the share passing to the trust will instead pass to the surviving descendants of the beneficiary, as a trust does not have descendants.

- If more than one beneficiary is listed and there is no indication of how the property should be divided, then the property transfers in equal shares to the beneficiaries who are listed.

- If you name only one beneficiary or one alternate beneficiary, you should enter "100%" in the percentage box for that person. If you name more than one beneficiary or alternate beneficiary, enter the percentage or fraction of the property that you want each beneficiary to receive.

- **It is very important that the shares you list add up to 100% (if you are using percentages) or to 1 (if you are using fractions). If there is a math error and the shares listed for all beneficiaries do not total 100% or 1, the property transfers to the surviving beneficiaries in proportions consistent with the assumed intent of the Owner.**

  For example:

  If you have five children and you want to transfer the property to them in equal shares when you have died, you would enter the following shares for each child:

  20% + 20% + 20% + 20% + 20% = 100% **-- *or* --** 1/5 + 1/5 + 1/5 + 1/5 + 1/5 = 1

  If you list three beneficiaries and you want all of them to receive an equal share, you should enter 1/3 for each beneficiary named:

  1/3 + 1/3 + 1/3 = 1

  If you have three children and you do not want them to have equal shares, you could give Child A 50% (or 1/2) of the property and give Child B and Child C 25% (or 1/4) each:

  50% + 25% + 25% = 100% **-- *or* –** 1/2 + 1/4 + 1/4 = 1

- Enter the relationship of the beneficiary to you, if applicable (i.e., "child", "brother", "friend," etc.). This information is not required but will be helpful in identifying the beneficiary if necessary.

- A beneficiary you name in the TODD may die before you do. If you want the shares of any named beneficiary who does not survive you to transfer to their surviving descendants, check the box provided for this purpose. If the box is not checked, or if that deceased beneficiary has no surviving descendants, then that deceased beneficiary's share transfers in the same proportion to the surviving beneficiaries. A person's descendants are their children, grandchildren, etc.

4. Alternate Beneficiary or Beneficiaries

Print the name of the alternate beneficiary or alternate beneficiaries you want to receive the property if all beneficiaries identified in Section 3 of the TODD form (and any of their descendants if the box was checked) have died. You can name up to four alternate beneficiaries on this form. Use additional pages if you want to name more than four alternate beneficiaries. *See* FAQ 3 for who or what can be listed as a beneficiary or alternate beneficiary.

Follow the instructions provided in #3 above for calculating shares of the property and completing the rest of this section of the form.

5. No Surviving Beneficiaries

You cannot change this section of the TODD. If all beneficiaries and alternate beneficiaries included in sections 3 and 4 on the form do not survive the Owner by at least 120 hours, the TODD becomes void and the property will pass as a part of the Owner's estate.

6. Error in Property Division

You cannot change this section of the TODD. It is very important that the shares for the beneficiaries or alternate beneficiaries total 100% or 1. If there is a math error and they do not total 100% or 1, the property transfers to the surviving beneficiaries in proportions consistent with the assumed intent of the Owner. This way, the whole property transfers under the TODD even if there is a math error.

7. Transfer of Property to Descendants

You cannot change this section of the TODD. If the "Share Transfers to Surviving Descendants" box is checked indicating that the property will transfer to the surviving descendants of a deceased beneficiary, then the deceased beneficiary's share will transfer to that deceased beneficiary's children in equal shares, with the share of any deceased child transferring to that deceased child's children in equal shares, and so on.

If you do not check the "Share Transfers to Surviving Descendants" box for any of the beneficiaries you have named in the form, then that beneficiary's share will be divided among the remaining beneficiaries. It will not go that beneficiary's children, grandchildren, etc.

8. Signatures and Dates

When the TODD form is completely filled out, you will need to sign the TODD in front of a Notary Public. A Notary Public needs to see you sign the form. You may need to show the Notary Public a form of identification. The Notary Public will complete and sign the Notary section. THIS IS VERY IMPORTANT – the TODD cannot be filed unless your signature is notarized.

9. "**After recording, return to:" Box**

In this box, write the name and address of the person you want the TODD form returned to after the County Clerk has recorded it. If you want it returned to you, enter your name and address.

IMPORTANT INFORMATION ABOUT THIS FORM:

- **A person acting as your agent under a Power of Attorney CANNOT sign this TODD for you. The Owner MUST sign it.**
- **DO NOT sign the TODD until you are in front of a Notary Public. The Notary Public MUST see you sign it.**
- **A TODD MUST be recorded in the County Clerk's office in each county where the property is located ("Deed Records") BEFORE you die. If not, the property will not transfer.**
- **The TODD beneficiary(s) MUST survive you by at least 120 hours. If none of the beneficiaries or alternate beneficiaries you name survive you, the TODD will not be effective to transfer the property.**
- **Filing Fees**: The County Clerk will charge a fee to file the TODD. You may want to call the County Clerk's office or check their website to find out how much it costs and what forms of payment they will take before you go.
- **Do Not File the Instructions**: If you file the instructions, it may cause confusion and will also cost you more money.

Notice of Confidentiality Rights: If you are a natural person, you may remove or strike any of the following information from this instrument before it is filed for record in the public records: Your social security number or your driver's license number.

Note: This form does not require either a social security number or driver's license number**.**

REVOCABLE TRANSFER ON DEATH DEED FOR INDIVIDUAL OWNER

1. Owner:

Full Name:

Address:

2. The "Property" is:

Physical Address of the Property:

Address:

Legal Description of the Property:

Insert the full legal description found on the deed (add additional pages if needed at the end):

3. Beneficiary or Beneficiaries:

Upon the death of the Owner, the Property transfers to the following beneficiary or beneficiaries listed below who survive the Owner by at least 120 hours.

If a beneficiary fails to survive the Owner by at least 120 hours and the box below is checked, that deceased beneficiary's share of the Property transfers instead to that beneficiary's surviving descendants (as defined below). If the box is not checked, or if that deceased beneficiary has no surviving descendants, then that deceased beneficiary's share transfers *pro rata* to the surviving beneficiaries.

If more than one beneficiary is listed, and there is no indication of how the Property should be divided, then the Property transfers in equal shares to the following beneficiaries who are listed below, or to the descendants of a beneficiary if indicated below.

Full Name:
Address:
Percentage or fractional share of the Property (see Instructions #3): ____________________
Relationship:
☐ **Share transfers to surviving descendants if beneficiary fails to survive Owner**

Full Name:
Address:
Percentage or fractional share of the Property (see Instructions #3): ____________________
Relationship:
☐ **Share transfers to surviving descendants if beneficiary fails to survive Owner**

Full Name:
Address:
Percentage or fractional share of the Property (see Instructions #3): ____________________
Relationship:
☐ **Share transfers to surviving descendants if beneficiary fails to survive Owner**

Full Name:
Address:
Percentage or fractional share of the Property (see Instructions #3): ____________________
Relationship:
☐ **Share transfers to surviving descendants if beneficiary fails to survive Owner**

4. Alternate Beneficiary or Beneficiaries:

If no beneficiary included in Section 3 above survives the Owner, then the Property transfers to the following alternate beneficiaries (or to the descendants of an alternate beneficiary, if indicated below) who survive the Owner by at least 120 hours.

If an alternate beneficiary fails to survive the Owner and the box below is checked, that alternate beneficiary's share of the Property transfers instead to that alternate beneficiary's surviving descendants (as defined below). If the box is not checked, or if that alternate beneficiary has no surviving descendants, then that alternate beneficiary's share transfers *pro rata* to the surviving beneficiaries.

If more than one alternate beneficiary is listed, and there is no indication of how the Property should be divided, then the Property transfers in equal shares to the following alternate beneficiaries who are listed below (or to the descendants of an alternate beneficiary if indicated below).

Full Name:

Address:

Percentage or fractional share of the Property (see Instructions #3): ____________________

Relationship:

☐ **Share transfers to surviving descendants if beneficiary fails to survive Owner**

Full Name:

Address:

Percentage or fractional share of the Property (see Instructions #3): ____________________

Relationship:

☐ **Share transfers to surviving descendants if beneficiary fails to survive Owner**

Full Name:

Address:

Percentage or fractional share of the Property (see Instructions #3): ____________________

Relationship:

☐ **Share transfers to surviving descendants if beneficiary fails to survive Owner**

Full Name:

Address:

Percentage or fractional share of the Property (see Instructions #3): ____________________

Relationship:

☐ **Share transfers to surviving descendants if beneficiary fails to survive Owner**

5. No Surviving Beneficiaries:

This Transfer on Death Deed shall have no effect if all beneficiaries and alternate beneficiaries included in sections 3 and 4 above fail to survive the Owner by at least 120 hours.

6. Distributions to a Minor (Optional):

If a beneficiary named in either section 3 or 4 (or a surviving descendant of a deceased beneficiary named in either section 3 or 4) is a minor when the Owner dies, the share passing to the beneficiary shall be held by the following named person as custodian under the Texas Uniform Transfers to Minors Act (UTMA):

Name of Custodian:	As custodian for [name of minor]:
Name of Custodian:	As custodian for [name of minor]:
Name of Custodian:	As custodian for [name of minor]:
Name of Custodian:	As custodian for [name of minor]:

Additional custodians may be added on an attachment to this Transfer of Death Deed.

7. Error in Property Division:

If the percentages or shares indicated in either section 3 or section 4 add up to more or less than all of the Property, then the Property transfers *pro rata* to the surviving beneficiaries or alternate beneficiaries, with each beneficiary receiving a percentage or share equal to that beneficiary's portion of the total listed. [An example of a pro rata distribution: If the box lists 3 beneficiaries each getting a 1/4 share of the Property (which only totals 3/4 of the Property), the Owner's intent will be interpreted to mean that each beneficiary will receive 1/3 share of the Property.]

8. Definition of Surviving Descendants:

If the box is checked indicating that the Property will transfer to the surviving descendants of a deceased beneficiary, then the deceased beneficiary's share will transfer to that deceased beneficiary's children in equal shares, with the share of any deceased child transferring to that deceased child's children in equal shares, and so on.

9. Revocation Prior to Death:

I understand that I have the right to revoke this Transfer on Death Deed at any time prior to my death.

10. Effect on Existing Transfer on Death Deed:

By signing and properly filing this document, the Owner revokes any prior Revocable Transfer on Death Deed regarding the Owner's interest in this Property.

11. Signature and Date:

____
Sign full name here

Dated: __________________________________

STATE OF TEXAS §
§
COUNTY OF ______________________ §

This instrument was acknowledged before me on __________________, 20__, by ____.

____
Notary Public, State of Texas

After recording, return to:

Name:
Address:

INSTRUCTIONS AND FAQs
REVOCABLE TRANSFER ON DEATH DEED
FOR MARRIED OWNERS OR TWO CO-OWNERS

You can use this **Revocable Transfer on Death Deed** ("TODD") form to transfer ownership of your real property located in Texas when you die without going to court. To sign a TODD, you must have the legal and mental capacity to sign a contract. The Transfer on Death Deed is authorized under Chapter 114 of the Texas Estates Code.

This TODD Set Contains four forms with frequently asked questions and instructions on how to complete the following forms: a Revocable Transfer on Death Deed for an Individual Owner, a Revocable Transfer on Death Deed for Married Owners or Two Co-Owners, a Cancellation of Revocable Transfer on Death Deed, and an Affidavit of Death.

Use this form if:

- You want to transfer your interest in the property to your spouse or co-owner. This form must be completed and signed by both Owners.
- You already filed a TODD in the deed records in the County Clerk's office of the county where the property is located, and you want to create a new TODD to change who will receive the property on your death.

Use the TODD form for Individual Owners if:

- You want to transfer your interest in the property to someone **other** than your spouse or co-owner.

Do not use this form if:

- You do not own an interest in the property. (However, it is okay to use this form if your interest in the property is subject to a mortgage.)

Helpful Words to Know:

- Community property: Real property is community property if it was acquired during your marriage, except for separate property acquired before or during the marriage.
- Separate property: Real property is separate property if you owned it before your marriage, received it during your marriage by gift or inheritance, or purchased it with separate property money.

The rules of community property and separate property are complicated. If you are not sure whether your property is community or separate property, contact a lawyer for advice.

NOTICE TO PROPERTY OWNERS: Carefully read all instructions for this form before completing and signing it. This form is designed to fit some but not all situations. If you have questions after reading these FAQs and instructions, you should contact a lawyer for advice. These instructions are not a substitute for the advice of an attorney.

For privacy and identity theft reasons, **do not** put your Social Security number or driver's license number on this form. They are not required.

A. FREQUENTLY ASKED QUESTIONS (FAQs)

1. What does a Transfer on Death Deed ("TODD") do?

A TODD transfers ownership of real property, including mineral interests, located in Texas to someone else when you die without going to court. It does not transfer any other kind of property, such as personal property (cars, cash, jewelry, etc.) or any real property located outside of Texas. If you want to use a TODD to transfer a mobile or manufactured home, see FAQ 9.

2. What does this Married Owners or Two Co-Owners Revocable TODD do?

The Married Owners or Two Co-Owners Revocable TODD form can be used by a married couple or two co-owners who want to give real property to the other Owner when the first Owner dies and then have the ownership pass to someone else after both Owners have died.

3. Who can I name as a beneficiary or alternate beneficiary in the Married Owners or Two Co-Owners Revocable TODD form?

This Married Owners or Two Co-Owners Revocable TODD form transfers your interest in the property to your spouse or co-owner when you die. If you want to transfer your interest in the property to someone else, use the TODD form and instructions for an Individual Owner instead.

The Married Owners or Two Co-Owners Revocable TODD form transfers the portion of the property owned by the person who dies first to the Surviving Owner. When the Surviving Owner dies, the property transfers to the beneficiary or alternate beneficiary listed in the TODD.

You can name anyone you want as beneficiary or alternate beneficiary to receive the property after the death of the Surviving Owner, including a family member, a friend or other person, a charity, an educational institution, a trustee of a trust (including the trustee of a revocable or irrevocable trust), a custodian under the Uniform Transfers to Minors Act, etc. You must include the name and address of each person or entity you name as beneficiary or alternate beneficiary, so make sure you have this information when you prepare the form. You do not have to notify any beneficiary that you have named them in the form, but it is recommended that you do.

4. Does a TODD change my ownership of the property or my ownership rights before I die?

No. Even though you must file the TODD in the deed records before you die, you still own your interest in the property and retain your interest in the property rights until you die. This includes the right to use your interest in the property as collateral for a loan, obtain property tax exemptions on your interest, make repairs or other improvements, sell, or transfer your interest in the property as long as the sale or transfer complies with marital property or other co-owner rights, etc.

5. Can my spouse or co-owner change or cancel the TODD after I die?

Yes. If you die first, the Surviving Owner will own your interest in the property and their own interest, and can cancel the TODD, prepare a new TODD, or transfer the property by any other legal means.

6. What happens when both of us die?

As long as the TODD is filed in the deed records in the County Clerk's office of each county where the property is located before your deaths, the property transfers to the beneficiary or beneficiaries named in the TODD (or to their descendants, if this option is chosen) who survive the Surviving Owner by at least 120 hours in the shares indicated in the TODD.

If all beneficiaries (and their descendants, if that option was chosen) are deceased or do not survive the Surviving Owner by at least 120 hours, then the property transfers to the alternate beneficiaries named in the TODD (or to their descendants, if that option was chosen) in the shares indicated in the TODD.

7. What property can I transfer using a TODD?

A TODD only transfers real property located in Texas. You can only transfer the portion of the real property that you own. A TODD does not transfer any other kind of property, such as personal property (cars, cash, jewelry, etc.) or any real property located outside of Texas. If you want to use a TODD to transfer a mobile or manufactured home, see FAQ 9.

This Married Owner or Two Co-Owner Revocable TODD form transfers your interest in the property to your spouse or co-owner when you die. If you want to transfer your interest in the property to someone else, use the TODD form and instructions for an Individual Owner instead.

8. Can I transfer more than one piece of property in this TODD form?

This TODD form is designed to transfer one piece of real property. If you own more than one piece of real property in Texas and you want to transfer additional properties using a TODD form, you should complete and file a separate TODD form for each piece of property.

9. Can I use a TODD to transfer a mobile or manufactured home?

If you want to use a TODD to transfer a mobile or manufactured home, you must:

- Own the real property that the mobile or manufactured home is permanently attached to,
- Have a Statement of Ownership declaring that the mobile or manufactured home is a part of the real property, and
- That Statement of Ownership must have been filed in the deed records in the County Clerk's office of each county where the mobile or manufactured home is located.

For more information, see the Texas Department of Housing and Community Affairs website at https://www.tdhca.state.tx.us/mh/ownership-location.htm and the Application for a Statement of Ownership form at https://www.tdhca.state.tx.us/mh/docs/1037-applysol.pdf.

10. What if I have a Will that leaves the property to someone else?

A properly filed TODD overrules a Will. The property transfers to the Surviving Owner or beneficiary named in the TODD, not the person named in your Will. This is true even if you make a Will after you have completed and filed the TODD. If you already have a Will or plan to sign one, contact a lawyer for advice about the best method for transferring your real and personal property upon your death.

11. **What do I do with the TODD after I fill it out and sign it?**

    Once you and your spouse or co-owner have completed the TODD and signed it in front of a Notary Public, you must file it in the deed records in the County Clerk's office of each county where the property is located. You may need to show the Notary Public a form of identification. You will have to pay a filing fee. Contact the County Clerk for more information. The County Clerk may file the TODD immediately and hand the original back to you, or the Clerk may mail the original TODD to the person you listed in the "After Recording, Return to:" box. Keep the original TODD in a safe place.

12. **Does the Surviving Owner or beneficiary need to do anything to claim the property when I die?**

    After an owner has died, an "Affidavit of Death" should be filed in the deed records in the County Clerk's office of each county where the TODD was filed. Filing the Affidavit of Death notifies the public that the property has transferred to the new owner or owners. The Affidavit of Death form included with this TODD form can be used at that time.

13. **If I change my mind, how can I "undo" a TODD?**

    If you change your mind, you can revoke (cancel) a TODD at any time before you die either by creating a new TODD or by completing a Cancellation of TODD form. You cannot revoke a TODD by tearing it up once it's been filed. The new TODD or the Cancellation of TODD must be filed in the deed records in each County Clerk's office where you originally filed a TODD. There will be a filing fee.

    NOTE: If you cancel your TODD or make a new one, it only affects the portion of the property that you own. It will not affect the ownership rights of any other co-owners.

14. **What happens if I get divorced after I have filed this Married or Two-Co-Owner Revocable TODD?**

    A TODD naming your spouse as beneficiary will remain in effect unless, before you die, a notice of the divorce judgment or a final decree of divorce is filed in the County Clerk's office in each county where the TODD was originally filed. A filed notice of the divorce judgment or final decree of divorce revokes (cancels) your ex-spouse as a beneficiary but does not change the alternate beneficiaries, such as your ex-spouse's children or relatives. A filed Cancellation of TODD or a new TODD will completely revoke the TODD.

    You can get a notice of divorce judgment or a final decree of divorce from the clerk of the court where your divorce was finalized. Check with the County Clerk's office where you filed the TODD to see if you need a certified copy of a notice of divorce judgment or a final decree of divorce. If so, you will need to get a certified copy from the clerk of the court where your divorce was finalized, and a fee may be charged.

    Because a notice of divorce judgment and a Cancellation of TODD are shorter than a divorce decree, they are significantly less expensive to file. A divorce decree may also include private information, such as the names of children or other private information, so it is best to use a notice of divorce judgment or a Cancellation of TODD.

15. What if I owe debts on the property I want to transfer?

You can sign a TODD to transfer the property even if there is a debt or lien on the property, such as a mortgage. The property transfers to the surviving owner or beneficiaries when you die even if there are debts or liens on the property. A TODD does not protect the property from your creditors. Any mortgages, liens, homeowners' association fees, property taxes, homeowners' insurance, etc., will still need to be paid as required. The property could also be used to pay any other unpaid debts at your death or expenses related to your death. A title company or other party asked to rely on the TODD may request proof that there are no such outstanding debts or expenses, including taxes. If you have questions or concerns about this, consult an attorney.

16. Will a TODD affect my Medicaid benefits?

No. It will not affect your Medicaid benefits because the property does not transfer until you die.

17. What if there is a Medicaid Estate Recovery Program (MERP) claim against my estate after I die?

If the State wants to be repaid after you die for Medicaid benefits you received during your lifetime, property properly transferred under a TODD is not subject to a MERP claim under current law. If you have questions or concerns about this, consult an attorney.

B. COMPLETING THE REVOCABLE TRANSFER ON DEATH DEED FOR MARRIED OR TWO CO-OWNER FORM

1. Owners

Enter the full names of both owners exactly as they appear on your original property deed. If either name has changed, enter the name as shown on the deed followed by "AKA" (also known as) and the owner's current name.

2. The "Property" is:

Physical Address of the Property: Enter the physical address of the property, including the number, street name, city, county, state, and zip code.

Legal Description of the Property: Print the legal description of the property, which is different from the mailing or physical address. Use the legal description exactly as it appears on your property deed. **It is very important that this information is correct**. If you do not have a copy of your property deed, you may request a copy from the County Clerk's office in the county where the property is located because it should have been filed there when you acquired the property. If you are not able to obtain a copy of your deed or are unsure of the legal description, you may want to consult an attorney.

If you have no other alternative, you can use the property description listed on your property tax statement but be aware that it may not be correct or sufficient to transfer title of the property to the surviving owner or beneficiary.

3. Death of One Owner

You cannot change this section of the TODD, which states that both Owners intend for the Surviving Owner to receive their interest in the property when the first Owner dies. (If you want to transfer your interest in the property to someone other than your spouse or co-owner, use the TODD form and instructions for an Individual Owner instead.)

4. Beneficiary or Beneficiaries

Print the name of the beneficiary or beneficiaries you want to receive the property when the Surviving Owner dies. You can name up to four beneficiaries on this form. Use additional pages if you want to name more than four beneficiaries. *See* FAQ 3 for who or what can be listed as a beneficiary. If you name the trustee of a revocable or irrevocable trust, you should use a format similar to the following:

> "[Name of trustee], trustee of the [Name of trust] under trust agreement dated [Date]"

You should also enter the address of the trustee and also indicate that the relationship of this beneficiary is either "revocable trust" or "irrevocable trust" (whichever applies). Do not check the box indicating that the share passing to the trust will instead pass to the surviving descendants of the beneficiary, as a trust does not have descendants.

- If more than one beneficiary is listed and there is no indication of how the property should be divided, then the property transfers in equal shares to the beneficiaries who are listed.

- If you name only one beneficiary or one alternate beneficiary, you should enter “100%” in the percentage box for that person. If you name more than one beneficiary or alternate beneficiary, enter the percentage or fraction of the property that you want each beneficiary to receive.

- **It is very important that the shares you list add up to 100% (if you are using percentages) or to 1 (if you are using fractions). If there is a math error and the shares listed for all beneficiaries do not total 100% or 1, the property transfers to the surviving beneficiaries in proportions consistent with the assumed intent of the Owners.**

  For example:

  If you and the other owner have five children and you want to transfer the property to them in equal shares when you both have died, you would enter the following shares for each child:

  20% + 20% + 20% + 20% + 20% = 100% **-- *or* --** 1/5 + 1/5 + 1/5 + 1/5 + 1/5 = 1

  If you list three beneficiaries and you want all of them to receive an equal share, you should enter 1/3 for each beneficiary named:

  1/3 + 1/3 + 1/3 = 1

  If you and the other owner have three children and you do not want them to have equal shares, you could give child A 50% (or 1/2) of the property and give child B and child C 25% (or 1/4) each:

  50% + 25% + 25% = 100% **-- *or* --** 1/2 + 1/4 + 1/4 = 1

- Enter the relationship of the beneficiary to you, if applicable (i.e., “child”, “brother”, “friend,” etc.). This information is not required but will be helpful in identifying the beneficiary if necessary.

- A beneficiary you name in the TODD may die before you do. If you want the shares of any named beneficiary who does not survive you to transfer to their surviving descendants, check the box provided for this purpose. If the box is not checked, or if that deceased beneficiary has no surviving descendants, then that deceased beneficiary's share transfers in the same proportion to the surviving beneficiaries. A person's descendants are their children, grandchildren, etc.

5. Alternate Beneficiary or Beneficiaries

Print the name of the alternate beneficiary or alternate beneficiaries you want to receive the property if the Surviving Owner and all beneficiaries identified in Section 4 of the TODD form (and any of their descendants if the box was checked) have died. You can name up to four alternate beneficiaries on this form. Use additional pages if you want to name more than four alternate beneficiaries. *See* FAQ 3 for who or what can be listed as a beneficiary or alternate beneficiary.

Follow the instructions provided in #4 above for calculating shares of the property and completing the rest of this section of the form.

6. No Surviving Beneficiaries

You cannot change this section of the TODD. If all potential beneficiaries and alternate beneficiaries included in sections 4 and 5 on the form do not survive the Owners by at least 120 hours, the property will pass as a part of the Surviving Owner's estate.

7. Error in Property Division

You cannot change this section of the TODD. It is very important that the shares for the beneficiaries or alternate beneficiaries total 100% or 1. If there is a math error and they do not total 100% or 1, the property transfers to the surviving beneficiaries in proportions consistent with the assumed intent of the Owners. This way, the whole property transfers under the TODD even if there is a math error.

8. Transfer of Property to Descendants

You cannot change this section of the TODD. If the "Share Transfers to Surviving Descendants" box is checked indicating that the property will transfer to the surviving descendants of a deceased beneficiary, then the deceased beneficiary's share will transfer to that deceased beneficiary's children in equal shares, with the share of any deceased child transferring to that deceased child's children in equal shares, and so on.

If you do not check the "Share Transfers to Surviving Descendants" box for any of the beneficiaries you have named in the form, then that beneficiary's share will be divided among the remaining beneficiaries. It will not go that beneficiary's children, grandchildren, etc.

9. Signatures and Dates

When the TODD form is completely filled out, both you and the other Owner will need to sign the TODD in front of a Notary Public. A Notary Public needs to see you sign the form. You may need to show the Notary Public a form of identification. The Notary Public will complete and sign the Notary section. THIS IS VERY IMPORTANT – the TODD cannot be filed unless your signatures are notarized.

10. "After recording, return to:" Box

In this box, write the name and address of the person you want the TODD form returned to after the County Clerk has recorded it. If you want it returned to you, enter your name and address.

IMPORTANT INFORMATION ABOUT THIS FORM:

- **A person acting as your agent under a Power of Attorney CANNOT sign this TODD for you. Both Owners MUST sign it.**
- **DO NOT sign the TODD until you are in front of a Notary Public. The Notary Public MUST see you sign it.**
- **A TODD MUST be recorded in the County Clerk's office in each county where the property is located ("Deed Records") BEFORE you die. If not, the property will not transfer.**
- **The TODD beneficiary(s) MUST survive you by at least 120 hours. If none of the beneficiaries you name survive you, the TODD will not be effective to transfer the property.**
- **Filing Fees**: The County Clerk will charge a fee to file the TODD. You may want to call the County Clerk's office or check their website to find out how much it costs and what forms of payment they will take before you go.
- **Do Not File the Instructions**: If you file the instructions, it may cause confusion and will also cost you more money.

Notice of Confidentiality Rights: If you are a natural person, you may remove or strike any of the following information from this instrument before it is filed for record in the public records: Your social security number or your driver's license number.

Note: This form does not require either a social security number or driver's license number**.**

REVOCABLE TRANSFER ON DEATH DEED
FOR MARRIED OWNERS OR TWO CO-OWNERS

1. Owners:

Full Name of Owner A:
Address:

Full Name of Owner B:
Address:

2. The "Property" is:

Physical Address of the Property:

Address:

Legal Description of the Property:

Insert the full legal description found on the deed (add additional pages if needed at the end):

3. Death of An Owner:

When the first of the Owners dies (the "Deceased Owner"), the Deceased Owner's interest in the Property transfers to the other Owner (the "Surviving Owner"). If the Owners die within 120 hours of each other, the Property transfers to the beneficiary or beneficiaries listed below who survive both Owners by at least 120 hours.

4. Beneficiary or Beneficiaries:

When both Owners have died, the Property transfers to the following beneficiaries listed below (or to the descendants of a beneficiary, if indicated below) who survive the Owners by at least 120 hours, in the shares indicated below.

If a beneficiary fails to survive the Owners by at least 120 hours and the box below is checked, that deceased beneficiary's share of the Property transfers instead to that beneficiary's surviving descendants (as defined below). If the box is not checked, or if that beneficiary has no surviving descendants, then that deceased beneficiary's share transfers *pro rata* to the surviving beneficiaries.

If more than one beneficiary is listed and there is no indication of how the Property should be divided, then the Property transfers in equal shares to the following beneficiaries who are listed below (or to the descendants of a beneficiary, if indicated below).

Full Name:		Percentage or fractional share of the Property (see Instructions #4): ________________
Address:		
Relationship:	☐ **Share transfers to surviving descendants if beneficiary fails to survive Owners**	

Full Name:		Percentage or fractional share of the Property (see Instructions #4): ________________
Address:		
Relationship:	☐ **Share transfers to surviving descendants if beneficiary fails to survive Owners**	

Full Name:		Percentage or fractional share of the Property (see Instructions #4): ________________
Address:		
Relationship:	☐ **Share transfers to surviving descendants if beneficiary fails to survive Owners**	

Full Name:

Address:

Percentage or fractional share of the Property (see Instructions #4): ____________________

Relationship:

☐ **Share transfers to surviving descendants if beneficiary fails to survive Owners**

5. Alternate Beneficiary or Beneficiaries:

If no beneficiary included in Section 4 survives the Owners, then the Property transfers to the following alternate beneficiaries who are listed below (or to the descendants of an alternate beneficiary, if indicated below) who survive the Owners by at least 120 hours.

If an alternate beneficiary fails to survive the Owners and the box below is checked, that alternate beneficiary's share of the Property transfers instead to that alternate beneficiary's surviving descendants (as defined below). If the box is not checked, or if that alternate beneficiary has no surviving descendants, then that alternate beneficiary's share transfers *pro rata* to the surviving beneficiaries.

If more than one alternate beneficiary is listed, and there is no indication of how the Property should be divided, then the Property transfers in equal shares to the following alternate beneficiaries who are listed below (or to the descendants of an alternate beneficiary, if indicated below).

Full Name:

Address:

Percentage or fractional share of the Property (see Instructions #4): ____________________

Relationship:

☐ **Share transfers to surviving descendants if beneficiary fails to survive Owners**

Full Name:

Address:

Percentage or fractional share of the Property (see Instructions #4): ____________________

Relationship:

☐ **Share transfers to surviving descendants if beneficiary fails to survive Owners**

Full Name:	Percentage or fractional share of the Property (see Instructions #4): ____________________
Address:	
Relationship:	☐ **Share transfers to surviving descendants if beneficiary fails to survive Owners**

Full Name:	Percentage or fractional share of the Property (see Instructions #4): ____________________
Address:	
Relationship:	☐ **Share transfers to surviving descendants if beneficiary fails to survive Owners**

6. No Surviving Beneficiaries

This Transfer on Death Deed shall have no effect if all beneficiaries and alternate beneficiaries included in sections 4 and 5 above fail to survive the Owners by at least 120 hours.

7. Distributions to a Minor (Optional):

If a beneficiary named in either section 4 or 5 (or a surviving descendant of a deceased beneficiary named in either section 4 or 5) is a minor after both Owners have died, then the share passing to the beneficiary shall be held by the following named person as custodian under the Texas Uniform Transfers to Minors Act (UTMA):

Name of Custodian:	As custodian for [name of minor]:
Name of Custodian:	As custodian for [name of minor]:
Name of Custodian:	As custodian for [name of minor]:
Name of Custodian:	As custodian for [name of minor]:

Additional custodians may be added on an attachment to this Transfer of Death Deed.

8. Error in Property Division:

If the percentages or shares indicated in either section 4 or section 5 add up to more or less than all of the Property, then the Property transfers *pro rata* to the surviving beneficiaries or alternate beneficiaries, with each beneficiary receiving a percentage or share equal to that beneficiary's portion of the total listed. [An example of a pro rata distribution: If the box lists 3 beneficiaries each getting a 1/4 share of the Property (which only totals 3/4 of the Property), the Owner's intent will be interpreted to mean that each beneficiary will receive 1/3 share of the Property.]

9. Definition of Surviving Descendants:

If the box is checked indicating that the Property will transfer to the surviving descendants of a deceased beneficiary, then the deceased beneficiary's share will transfer to that deceased beneficiary's children in equal shares, with the share of any deceased child transferring to that deceased child's children in equal shares, and so on.

10. Right to Revoke Prior to Death:

Either Owner has the right to revoke this Revocable Transfer on Death Deed as to that Owner's interest at any time prior to that Owner's death.

11. Effect on Existing Transfer on Death Deed:

By signing and properly filing this document, an Owner revokes any prior Revocable Transfer on Death Deed regarding that Owner's interest in this Property.

Signatures page follows

11. Signatures and Dates:

____
First Owner – Sign full name here

STATE OF TEXAS §
§
COUNTY OF _____________________ §

This instrument was acknowledged before me on __________________, 20__, by ____.

____
Notary Public, State of Texas

****

____
Second Owner – Sign full name here

STATE OF TEXAS §
§
COUNTY OF _____________________ §

This instrument was acknowledged before me on __________________, 20__, by ____.

____
Notary Public, State of Texas

After recording, return to:

Name:
Address:

INSTRUCTIONS AND FAQs
CANCELLATION OF REVOCABLE TRANSFER ON DEATH DEED

You can use this Cancellation of Revocable Transfer on Death Deed form to cancel any Transfer on Death Deed (TODD) that has been filed, including the Revocable Transfer on Death Deed for Individual Owner and the Revocable Transfer on Death Deed for Married Owners or Two Co-Owners. The Transfer on Death Deed is authorized under Chapter 114 of the Texas Estates Code.

This TODD Set Contains four forms with frequently asked questions and instructions on how to complete the following forms: a Revocable Transfer on Death Deed for an Individual Owner, a Revocable Transfer on Death Deed for Married Owners or Two Co-Owners, a Cancellation of Revocable Transfer on Death Deed, and an Affidavit of Death.

Use this form if:

- You already filed a TODD in the deed records in the County Clerk's office of each county where the property is located, and you want to cancel the TODD without creating a new one.

Do not use this form if:

- You already filed a TODD in the deed records in the County Clerk's office of each county where the property is located, and you want to create a new TODD to change who will receive the property on your death. It is not necessary to file both a Cancellation of TODD and a new TODD. You can simply complete and file a new Revocable Transfer on Death Deed for Individual Owners or the Revocable Transfer on Death Deed for Married Owners or Two Co-Owners.

NOTICE TO PROPERTY OWNERS: Carefully read all instructions for this form before completing and signing it. This form is designed to fit some but not all situations. If you have questions after reading these FAQs and instructions, you should contact a lawyer for advice. These instructions are not a substitute for the advice of an attorney.

For privacy and identity theft reasons, **do not** put your Social Security number or driver's license number, or any other sensitive or private information on this form. They are not required.

A. FREQUENTLY ASKED QUESTIONS (FAQs)

1. If I change my mind, how can I "undo" a TODD?

If you change your mind, you can revoke (cancel) a TODD at any time before you die either by creating a new TODD or by completing a Cancellation of TODD form. You cannot revoke a TODD by tearing it up once it's been filed.

If you want to cancel the TODD and do not want to transfer the property to someone else using a TODD, use the Cancellation of TODD form. If you want to create a new TODD to change who will receive the property on your death, you can simply complete and file a new Revocable Transfer on Death Deed for Individual Owners or the Revocable Transfer on Death Deed for Married or Two Co-Owners. The new TODD or the Cancellation of TODD must be filed in the deed records in each County Clerk's office where you originally filed a TODD. There will be a filing fee.

NOTE: If you cancel your TODD or make a new one, it only affects the portion of the property that you own. It will not affect the ownership rights of any other co-owners. See FAQ 4.

2. **Can I just tear up my TODD to cancel it?**

   No. Tearing up or destroying your TODD will not cancel it.

3. **What happens if I cancel my TODD without making a new one?**

   Your interest in the property can pass to someone else in a variety of ways. The most common ways are through another type of deed to the property, through a Will, or through Texas laws if you die without a Will.

4. **If I used the Revocable Transfer on Death Deed for Married Owners or Two Co-Owner's form and I am the only one who wants to change it, do both of us need to sign the Cancellation of TODD form?**

   No. You can file this Cancellation of TODD form, which will cancel the transfer of your interest in the property.

5. **If I used the Revocable Transfer on Death Deed for Married Owners or Two Co-Owner's form and both of us want to change it, what do we do?**

   If both of you want to cancel the TODD, you should each file a Cancellation of TODD.

6. **Should I cancel my TODD if I get divorced?**

   Maybe. A divorce does not automatically cancel a TODD naming your ex-spouse or the children or relatives of your ex-spouse. The TODD will remain in effect unless a final decree of divorce, a notice of the divorce judgment, a Cancellation of TODD, or a new TODD is filed in the deed records in the County Clerk's office in each county where the TODD was originally filed.

   You can get a final decree of divorce or a notice of divorce judgment from the clerk of the court where your divorce was finalized. Check with the County Clerk's office where you filed the TODD to see if you need a certified copy of the final decree of divorce or the notice of final judgment of divorce. If so, you will need to get a certified copy from the clerk of the court where your divorce was finalized, and a fee may be charged.

   Because a Cancellation of TODD and a notice of divorce judgment are shorter than a divorce decree, they are significantly less expensive to file. A divorce decree may also include private information, such as the names of children or other private information, so it is best to use a Cancellation of TODD or a notice of divorce judgment.

B. COMPLETING THE CANCELLATION OF REVOCABLE TRANSFER ON DEATH DEED FORM

1. **Owner**:

   Enter the owner's full name exactly as it appears on your original property deed. If your name has changed, enter the name as shown on the deed followed by "AKA" (also known as) and your current name.

2. **Physical Address of the Property**:

   Enter the physical address of the property, including the number, street name, city, county, state, and zip code.

3. **Legal Description of the Property**:

   Print the legal description of the property, which is different from the mailing or physical address. Use the legal description exactly as it appears on your TODD. **It is very important that this information is correct**. If you do not have your TODD, you may request a copy from the County Clerk's office in the county where the TODD was filed, which should be the county where the property is located. Some County Clerks' offices have a copy of your TODD available online. If you are not able to obtain a copy of your TODD or are unsure of the legal description, you may want to consult an attorney.

4. **Cancellation**: This section states you are cancelling your TODD. You cannot make changes to this section.

5. **Signature and Date:**

   When the form is completely filled out, you will need to sign the form in front of a Notary Public. A Notary Public needs to see you sign the form. You may need to show the Notary Public a form of identification. The Notary Public will complete and sign the Notary section. THIS IS VERY IMPORTANT – the Cancellation of TODD cannot be filed unless your signature is notarized.

6. **"After recording, return to:" Box**

   In this box, write the name and address of the person you want the TODD form returned to after the County Clerk has recorded it. If you want it returned to you, enter your name and address.

IMPORTANT INFORMATION ABOUT THIS FORM:

- **DO NOT sign the Cancellation of TODD until you are in front of a Notary Public. The Notary Public MUST see you sign it.**

- **A Cancellation of TODD MUST be recorded in the deed records in the County Clerk's office of each county where the property is located <u>BEFORE</u> you die. If not, the existing TODD will not be cancelled.**

- **Filing Fees**: The County Clerk will charge a fee to file the Cancellation of TODD. You may want to call the County Clerk's office or check their website to find out how much it costs and what forms of payment they will take before you go.

- **Do Not File the Instructions**: If you file the instructions, it may cause confusion and will also cost you more money.

CANCELLATION OF REVOCABLE TRANSFER ON DEATH DEED

1. Owner:

Full Name:
Address:

2. The “Property” is:

Physical Address of the Property:

Address:

Legal Description of the Property:

Insert the full legal description found on the deed (add additional pages if needed at the end):

3. Cancellation:

I cancel all of my previous transfers of the Property by transfer on death deed.

4. Signature and Date:

Do not sign or date until you are in front of a notary. *Once the Cancellation of Revocable Transfer on Death Deed is signed and notarized, you **must** file it with the county clerk in the county where the property is located.*

____
Sign full name here

Dated: ______________________________

STATE OF TEXAS §
§
COUNTY OF ______________________ §

This instrument was acknowledged before me on __________________, 20__, by ____.

____
Notary Public, State of Texas

After recording, return to:

Name:
Address:

INSTRUCTIONS AND FAQs
AFFIDAVIT OF DEATH

A TODD beneficiary can use this Affidavit of Death to establish that the Owner who signed a Revocable Transfer on Death Deed (TODD) has died. This Affidavit of Death is to be used with the Revocable Transfer on Death Deed forms approved by the Supreme Court of Texas. The Transfer on Death Deed is authorized under Chapter 114 of the Texas Estates Code.

This TODD Set Contains four forms with frequently asked questions and instructions on how to complete the following forms: a Revocable Transfer on Death Deed for an Individual Owner, a Revocable Transfer on Death Deed for Married Owners or Two Co-Owners, a Cancellation of Revocable Transfer on Death Deed, and an Affidavit of Death.

Use this form if:

- You are a named beneficiary of a TODD and need to establish that the real property Owner who created the TODD has died.
- You are a Co-Owner named as a Surviving Owner in a TODD and need to establish that the other Co-Owner has died.

Do not use this form if:

- The real property Owner has not died.
- It has been less than the period of survival required in the TODD since the deceased Owner died or if the TODD does not state a period of survival, it has been less than 120 hours.

NOTICE TO SURVIVING BENEFICIARY: Carefully read all instructions for this form before completing and signing it. This form is designed to fit some but not all situations. If you have questions after reading these FAQs and instructions, you should contact an attorney for advice. These instructions are not a substitute for the advice of an attorney.

For privacy and identity theft reasons, **do not** put your or the deceased Owner's Social Security number, driver's license number, or any other sensitive or private information on this form. Do not attach the death certificate. This information is **not** required.

A. FREQUENTLY ASKED QUESTIONS (FAQs)

1. When Should I File an Affidavit of Death?

You should file the Affidavit of Death as soon as possible after the period of survival stated in the TODD or if the TODD does not state a period of survival, after 120 hours has passed.

2. Why Do I Need to File an Affidavit of Death?

An Affidavit of Death lets the public, including title companies, know that the property owner has died and ownership of the property has transferred to the Surviving Owner, beneficiary, or beneficiaries. It is also helpful in other situations, such as when:

- Continuing payments to the current mortgage lender, if one exists;
- Dealing with the County Appraisal District to get a homestead exemption or get or remove

other exemptions, or when assessing the value of the property for property tax purposes;
- Insuring the property;
- Selling the property;
- Borrowing money against the property;
- Applying for FEMA relief if the property is damaged during a disaster; or
- Applying for Medicaid Estate Recovery Programs, Exemption, or Waiver.

3. Who can sign an Affidavit of Death?

Usually, the Surviving Owner or a beneficiary named in the TODD signs the Affidavit, but anyone who is competent, at least 18 years old, and willing to swear that the facts stated in the Affidavit are true may sign it.

4. What Happens if I Don't File an Affidavit of Death?

If you don't file the Affidavit, it can slow down your ability to deal with the property as an owner.

5. Where do I File the Affidavit of Death?

You must file the Affidavit in the deed records in the County Clerk's office of the county where the TODD was filed. If a TODD was filed in more than one county, you must file a separate Affidavit in the deed records in the County Clerk's office in each county.

6. Do I need to bring anything to prove the Owner died when I file the Affidavit of Death?

No. You do not need to bring a death certificate or obituary to file the Affidavit but a title company may require proof of death.

7. What if I don't want the property or I am receiving public benefits?

Contact a lawyer as soon as you can to avoid potential costs and problems, especially if you are receiving public benefits.

B. COMPLETING THE AFFIDAVIT OF DEATH FORM

1. Information of Person Signing Affidavit: Enter your first, middle (if any), and last name.

2. Transfer on Death Deed Filed by Decedent:
    - Enter the name of the person who signed the TODD and has now died exactly as it appeared in the TODD. This person is called the "Decedent" in this Affidavit.
    - Enter in the appropriate blanks the name of the county where the TODD was filed.
    - Enter the instrument or document number the Clerk assigned to the TODD, and the volume and page number if you have it. Some counties may not include volume and page numbers. This information can be found on the filed and recorded TODD. If you don't have a recorded copy of the TODD, you can get a copy at the County Clerk's office in the county where it was filed. Some County Clerks' offices have a copy of the TODD available online.

3. Information of Person Who Signed the Transfer on Death Deed: Enter the date the Decedent died, and the city, county, state, and country where the person died in the box.

4. Signature and Date: This Affidavit must be signed in front of a notary. Do not sign your name or enter the date until a notary can see you sign the document. The Notary Public will complete and sign the Notary section.

5. "After Recording, Return to" Section: After recording, the Clerk will return the Affidavit to the person whose name is in the box. Enter the name and address of that person. If you want it returned to you, enter your name and address.

IMPORTANT INFORMATION ABOUT THIS FORM:

- **DO NOT sign the Affidavit of Death until you are in front of a Notary Public. The Notary Public MUST see you sign it.**

- **An Affidavit of Death should be recorded in the deed records in the County Clerk's office of each county where the property is located to show that the Owner who signed a revocable TODD has died.**

- **Filing Fees**: The County Clerk will charge a fee to file the Affidavit of Death. You may want to call the County Clerk's office or check their website to find out how much it costs and what forms of payment they will take before you go.

- **Do Not File the Instructions**: If you file the instructions, it may cause confusion and will also cost you more money.

AFFIDAVIT OF DEATH

STATE OF TEXAS §
§
COUNTY OF ______________________ §

I swear that the following statements are true:

1. **Person Signing Affidavit:**

My name is ____ (print Full Name). I am at least eighteen (18) years old and am competent to make this affidavit.

2. **Transfer on Death Deed Filed by Decedent:**

- *Print the first, middle and last name of the deceased Owner who signed the Transfer on Death Deed for the property exactly as it appeared on the Transfer on Death Deed. This person is now called the "Decedent."*
- *Print the county where the Transfer on Death Deed was filed.*
- *Print the deed's document or instrument number, where the Transfer on Death Deed was recorded. If you have the volume and page number, fill in those blanks. At a minimum, you must fill in the blank for document or instrument number OR the blanks for the volume and page number.*

____ (Decedent's Full Name) signed a Transfer on Death Deed that was filed in the deed records in the County Clerk's office in ______________________________ County, Texas, and can be found under document or instrument number ______________________________ in Volume ______________________________, Page ______________________________ of the County Clerk's records.

3. **Information of Decedent Who Signed the Transfer on Death Deed:**

- *Print the date the person died, and the county, state, and country where the person died.*

Date of Death: ____

City, County, State, and Country of Death: ____

4. **Signature and Date:**

Do not sign or date until you are in front of a notary. *Once the Affidavit of Death is signed and* *notarized, you **must** file it in the deed records in the County Clerk's office of the county where the Property is located.*

____
Sign full name here

Dated: ____________________________________

STATE OF TEXAS §
§
COUNTY OF ____________________ §

This instrument was acknowledged before me on _________________, 20__, by ____ (Name of Person Signing Affidavit).

____
Notary Public, State of Texas

After recording, return to:

Name:
Address:

Tab P

PROBATE AND ALTERNATIVES TO PROBATE:

The House Judiciary and Civil Jurisprudence Committee asked the Texas Access to Justice Commission to report on access to probate by the poor in April 2014. As a result, a group comprised of probate attorneys, judges, professors, real estate attorneys, bankers, and the access to justice community was convened over the summer to work on these recommendations. A Transfer on Death Deed bill resulted.

1. SB 462 (Huffman)/HB 703 (Farrar), Transfer on Death Deed

- A Transfer on Death Deed (TODD) allows people to properly transfer real property outside of probate, avoiding the cost of probate and cloudy title issues.
- The family home may be a low-income family's only valuable asset. Yet they cannot afford to have a will prepared or to probate a will – the current mechanisms to pass clear title to their heirs.
    - For these Texans, property passes by intestate succession, which can lead to "cloudy" title due to multiple family members co-owning the property.
    - Consolidating ownership can be so costly and complicated that families abandon the property.
    - Clear title allows Texans to sell our property, use it as collateral on a loan, or qualify for property tax exemptions.
- Failure to properly transfer title to property is a serious problem for the Texas communities and our low-income residents. Commonly seen situations include:
    - A decedent's disabled child living in the family home gets behind on property taxes causing the home to be foreclosed. If title had properly passed, the property tax disability exemption would apply and no taxes would have been owed.
    - The value of the home is so small that it will not cover the cost of probate. These properties are frequently abandoned, causing blight and an invitation to crime in our Texas neighborhoods.
- Under the proposed legislation, a TODD:
    - Serves as a will substitute for real property, allowing owner to transfer real property upon their death to a beneficiary without the need for the beneficiary to go through probate court;
    - Allows owner to keep all rights of property ownership during lifetime;
    - Does not give beneficiary any right to the property during the owner's lifetime;
    - It does not affect the rights or interests of any secured or unsecured creditors and it cannot be used to avoid the debts of the owner's estate; and
    - Must be recorded in county in which property is located – an associated cost of less than $25.
- The proposed bill includes a model TODD form, a model revocation form, and FAQs and instructions on the use of these forms.

Tab Q

Transfer on Death Deed
Questions and Answers

Question	Answer
How does a Transfer on Death Deed (TODD) work?	A property owner fills out a TODD during his/her lifetime, selecting a beneficiary and alternate beneficiary. The owner files the TODD at the county records office in the county in which the property is located. Upon the property owner's death, the property transfers to the beneficiary. If the beneficiary is deceased, the property would go to any designated beneficiary. A death certificate filed at the county records office demonstrates the transfer.
What alternatives to probate currently exist under Texas law?	Transfer on Death Accounts; Joint Tenancy with the Right of Survivorship; and Lady Bird Deeds. The report Trish submitted for the interim hearing gives a summary of the current alternatives.
How is a TODD different from a Lady Bird deed (LBD)?	With a TODD, the transferor retains full title. With a LBD, the transferor only retains an enhanced life estate but is not able to sell or otherwise encumber the property without authorization from the beneficiary of the LBD. A TODD allows the transferor to retain all property owner rights and provides clear title for disaster relief situations. An LBD does not.
How are affidavits of heirship different from a TODD?	Affidavits of heirship don't pass actual title themselves. Title passes only if and when the title company accepts them, which they don't have to do. In practice, attorneys report different results when using affidavits of heirship as a vehicle to transfer title. For example, in Travis County, attorneys have not had problems with title companies accepting the affidavits of heirship and title passing this way, but we have received reports that attorneys in more rural areas and the Valley have had issues. TODDs are preferred over heirship without administration because the property owner gets to decide who gets the property with a TODD. Under an heirship without administration, the property passes under intestate succession rules, which may be counter to the property owner's wishes.
Why is the intestacy system an issue?	Courts must decide how property is distributed after a person's death based on statute, rather than the property owner's decision. A probate court's determination may not align with the property owner's wishes. The process to probate an intestate estate is cumbersome, expensive, and plagued with the problem of unknown heirs. Also, proportional distribution among many heirs, who may die intestate themselves, can lead to generational title issues. Intestate succession inevitably leads to multiple owners of the property and this co-ownership can lead to cloudy title.
Why is cloudy title an issue?	

Transfer on Death Deed
Questions and Answers

	Cloudy title causes many complications for title companies, banks, and property owners. Title companies are hesitant to give title insurance on property that does not have clear title. Banks do not give mortgages on properties without clear title. Property owners suffer from both of the aforementioned problems, as well as inaccessibility to homestead rights, federal disaster relief, and property tax exemptions, such as over 65 and disability. All of these issues cause blight, property devaluation, and a general breakdown of the community.
Are court costs a barrier to probate?	Yes. Although costs vary across county lines, it is much more expensive to go through probate, which can cost thousands of dollars than record the deed, which should be less than $50. For example, in Travis county, the application for probate of a will is $304 and the application for determination of heirship (when the deceased is intestate) is $756. Other costs such as running a legal notice to creditors in the newspaper must also be paid. And because you cannot represent yourself in Texas probate courts except in very limited circumstances, you must add attorney's fees to the total cost. However, to record a Deed in Travis County you pay $26 for the first page and $4 for each additional page.
Challenges to TODD (e.g. undue influence)	Any statute or common law that applies to estates also applies to TODD property, unless otherwise stated in the legislation (e.g. undue influence would be challenged the same way as with a will. See Sec. 114.103(a) of the bill.)
How are creditors addressed?	Sec. 114.014 sets out a process for creditors to make a claim on the property. The property passes subject to all liens and encumbrances. A lienholder could continue to accept payments on the lien from the beneficiary once the property is transferred. If, however, the lienholder so chooses, he/she may make a claim on the estate. The claim process would then be the same as it is for any item in the estate.
What is the capacity standard?	The same capacity as is required to make a contract, which is a higher threshold than testamentary capacity. Sec. 114.054.
Why are witnesses not required?	The TODD has to be recorded prior to the property owner's death, which lends credibility to capacity and intent. We also did not want to place a higher standard on TOD deed than with other deeds.

Transfer on Death Deed
Questions and Answers

Can a Durable Power of Attorney sign and/or revoke a TODD?	Yes. A TODD does not change the authority of an attorney-in-fact under a durable power of attorney to make decisions/contracts in real estate if granted that authority.
What is the difference between “beneficiary”, “designated beneficiary” and “transferee”?	“Transferee”, used in Sec. 114.101(2), refers to someone who is not named in the TODD that acquires property, i.e. the transferor files a TODD but later sells the property to someone not named in the deed. The purchaser/new owner is a “transferee” under Sec. 114.101(2). Both “beneficiary” and “designated beneficiary” refer to people who would receive the property under a TODD.
Why is there no self-proving affidavit like there is for a will?	No deed has a self-proving affidavit. While TODDs are will substitutes, they are deeds.
Will the TODD increase probate costs since a title search will have to be run?	TODDs must be recorded to be effective. The county records office can be searched for recorded deeds. Most Texas counties have this information available to search online on the county clerk's or county appraiser's website. For those that don’t, an Ownership and Encumbrance Report can be purchased from the local title company covering the decedent’s period of ownership (or from enactment of TODD legislation if that’s the sole concern). Cost varies $75 - $150. The report may have other uses, such as identifying debts or claims against the estate.

Tab R

MEMORANDUM

TO: Supreme Court Advisory Committee

FROM: Appellate Subcommittee

DATE: October 29, 2024

RE: Proposed Response to the State Bar Rules Committee's 2015 Suggestion

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As the Committee will remember, at the last meeting, we took up the issue of the State Bar Rules Committee's proposal for amendments to TRAP 9.4, 38.1 and 38.2. The purpose of the State Bar Rules Committee's proposal was to add a requirement for a new section for each argument in an appellant's/cross-appellant's brief that would detail error preservation. This section would not include argument and would not count against the brief's word limit. [*See* attached Exhibit A].

The Appellate Subcommittee asked whether the Committee thought a preservation requirement was necessary. And, if so, the Subcommittee proposed an alternative fix.

After the last meeting's discussion, the Committee was of the tentative opinion that appellants/cross-appellants should be required by the rule to detail error preservation. Chair Babcock asked the Appellate Subcommittee to refine its alternative suggestion in accordance with the Committee's discussions.

The Subcommittee proposes two options to amend TRAP 38.1 and 38.2(b) detailed below. Option Two merely refers to Rule 33.1, which already explains that preservation is "a prerequisite to presenting a complaint for appellate review," and details what the record must contain for adequate preservation. [*See* attached Exhibit B].

Regardless of the option selected, the Appellate Subcommittee sees no reason to exempt preservation citations and arguments from the word count of TRAP 9.4.

OPTION ONE:

TRAP 38.1(i) be amended as follows:

> (i) *Argument*. The brief must contain a clear and concise argument for the contentions made, with appropriate citations to the authority and to the record. ***For each appellate contention, the brief must also contain citations to the record where the contention was raised and ruled upon by the trial court, or an explanation of why a complaint and ruling were not necessary to preserve the alleged error.***

Of course, a similar amendment must be made to Texas Rule of Appellate Procedure 38.2 - *Appellee's Brief*. We propose adding a paragraph (3) to 38.2(b) - *Form of Brief* as follows:

> ***(3) If an appellee raises cross-points, the appellee's brief must contain citations to the record where the contention was raised and ruled upon by the trial court, or an explanation of why a complaint and ruling were not necessary to preserve the alleged error.***

OPTION TWO:

TRAP 38.1(i) be amended as follows:

> (i) *Argument*. The brief must contain a clear and concise argument for the contentions made, with appropriate citations to the authority and to the record. ***For each appellate contention, the brief must also contain the information required by Rule 33.1***.

Of course, a similar amendment must be made to Texas Rule of Appellate Procedure 38.2 - *Appellee's Brief*. We propose adding a paragraph (3) to 38.2(b) - *Form of Brief* as follows:

> TRAP 38.2: ***If an appellee raises cross-points, for each appellate contention, the appellee's brief must include the information required by Rule 33.1***.

The Appellate Subcommittee expressed reservations about whether the word "contention" is really the right choice for an error-preservation standard. The options shown above use the word "contention" because that word already appears in the existing rules.

The subcommittee invites discussion about whether an alternative word, such as "issue" or "point," should be used in place of "contention" for these purposes to reduce the risk of unwarranted briefing waiver holdings on appeal.

Parties must identify "issues presented" in their briefs. An issue presented may encompass multiple legal or factual "contentions."

In some circumstances—for example, those involving a traditional summary judgment under Rule 166a(c)—the contentions supporting an issue presented on appeal seeking affirmance of summary judgment need to be stated in the trial court motion as "specific grounds." In other circumstances—for example, when addressing a motion for JNOV under Rule 301—there is more room in an appellate brief to expand the scope of the "contention" on appeal based on a bare-bones "immateriality" ground presented in the trial court JNOV motion. Preservation of a "contention" in these two circumstances may be analyzed differently based on the different contexts.

For this reason, use of an alternative word in place of "contention" warrants consideration for purposes of requiring error-preservation citations in briefs.

Tab S

Topic 1: Error Preservation Citations

STATE BAR COURT RULES COMMITTEE

PROPOSED AMENDMENT TO TEXAS RULE OF APPELLATE PROCEDURE 9.4

I. Exact Language of Existing Rule

9.4. Form

Except for the record, a document filed with an appellate court, including a paper copy of an electronically filed document, must--unless the court accepts another form in the interest of justice -- be in the following form:

(a) *Printing*. A document may be produced by standard typographic printing or by any duplicating process that produces a distinct black image. Printing must be on one side of the paper.

(b) *Paper Type and Size*. The paper on which a document is produced must be 8 1/2 by 11 inches, white or nearly white, and opaque.

(c) *Margins*. Documents must have at least one-inch margins on both sides and at the top and bottom.

(d) *Spacing*. Text must be double-spaced, but footnotes, block quotations, short lists, and issues or points of error may be single-spaced.

(e) *Typeface*. A document produced on a computer must be printed in a conventional typeface no smaller than 14-point except for footnotes, which must be no smaller than 12-point. A typewritten document must be printed in standard 10-character-per-inch (cpi) monospaced typeface.

(f) *Binding and Covering*. A paper document must be bound so as to ensure that it will not lose its cover or fall apart in regular use. A paper document should be stapled once in the top left-hand corner or be bound so that it will lie flat when open. A paper petition or brief should have durable front and back covers which must not be plastic or be red, black, or dark blue.

(g) *Contents of Cover*. A document's front cover, if any, must contain the case style, the case number, the title of the document being filed, the name of the party filing the document, and the name, mailing address, telephone number, fax number, if any, email address, and State Bar of Texas identification number of the lead counsel for the filing party. If a party requests oral argument in the court of appeals, the request must appear on the front cover of that party's first brief.

(h) *Appendix and Original Proceeding Record*. A paper appendix may be bound either with the document to which it is related or separately. If separately bound, the appendix must comply with paragraph (f). A paper record in an original proceeding or a paper appendix must be tabbed and indexed. An electronically filed record in an original proceeding or an electronically filed appendix that includes more than one item must contain bookmarks to assist in locating each item.

(i) *Length.*

(1) Contents Included and Excluded. In calculating the length of a document, every word and every part of the document, including headings, footnotes, and quotations, must be counted except the following: caption, identity of parties and counsel, statement regarding oral argument, table of contents, index of authorities, statement of the case, statement of issues presented, statement of jurisdiction, statement of procedural history, signature, proof of service, certification, certificate of compliance, and appendix.

(2) Maximum Length. The documents listed below must not exceed the following limits:

(A) A brief and response in a direct appeal to the Court of Criminal Appeals in a case in which the death penalty has been assessed: 37,500 words if computer-generated, and 125 pages if not.

(B) A brief and response in an appellate court (other than a brief under subparagraph (A)) and a petition and response in an original proceeding in the court of appeals: 15,000 words if computer-generated, and 50 pages if not. In a civil case in the court of appeals, the aggregate of all briefs filed by a party must not exceed 27,000 words if computer-generated, and 90 pages if not.

(C) A reply brief in an appellate court and a reply to a response to a petition in an original proceeding in the court of appeals: 7,500 words if computer-generated, and 25 pages if not.

(D) A petition and response in an original proceeding in the Supreme Court, a petition for review and response in the Supreme Court, a petition for discretionary review in the Court of Criminal Appeals, and a motion for rehearing in an appellate court: 4,500 words if computer-generated, and 15 pages if not.

(E) A reply to a response to a petition for review in the Supreme Court, a reply to a response to a petition in an original proceeding in the Supreme Court, and a reply to a petition for discretionary review in the Court of Criminal Appeals: 2,400 words if computer-generated, and 8 pages if not.

(3) Certificate of Compliance. A computer-generated document that is subject to a word limit under this rule must include a certificate by counsel or an unrepresented party stating the number of words in the document. The person certifying may rely on the word count of the computer program used to prepare the document.

(4) Extensions. A court may, on motion, permit a document that exceeds the prescribed limit.

(j) *Electronically Filed Documents.* An electronically filed document must:

(1) be in text-searchable portable document format (PDF);

(2) be directly converted to PDF rather than scanned, if possible;

(3) not be locked;

(4) be combined with any appendix into one computer file, unless that file would exceed the size limit prescribed by the electronic filing manager; and

(5) otherwise comply with the Technology Standards set by the Judicial Committee on Information Technology and approved by the Supreme Court.

(k) *Nonconforming Documents.* If a document fails to conform with these rules, the court may strike the document or identify the error and permit the party to resubmit the document in a conforming format by a specified deadline.

II. Proposed Changes to Existing Rule

9.4. Form

Except for the record, a document filed with an appellate court, including a paper copy of an electronically filed document, must--unless the court accepts another form in the interest of justice -- be in the following form:

(a) *Printing*. A document may be produced by standard typographic printing or by any duplicating process that produces a distinct black image. Printing must be on one side of the paper.

(b) *Paper Type and Size*. The paper on which a document is produced must be 8 1/2 by 11 inches, white or nearly white, and opaque.

(c) *Margins*. Documents must have at least one-inch margins on both sides and at the top and bottom.

(d) *Spacing*. Text must be double-spaced, but footnotes, block quotations, short lists, and issues or points of error may be single-spaced.

(e) *Typeface*. A document produced on a computer must be printed in a conventional typeface no smaller than 14-point except for footnotes, which must be no smaller than 12-point. A typewritten document must be printed in standard 10-character-per-inch (cpi) monospaced typeface.

(f) *Binding and Covering*. A paper document must be bound so as to ensure that it will not lose its cover or fall apart in regular use. A paper document should be stapled once in the top left-hand corner or be bound so that it will lie flat when open. A paper petition or brief should have durable front and back covers which must not be plastic or be red, black, or dark blue.

(g) *Contents of Cover*. A document's front cover, if any, must contain the case style, the case number, the title of the document being filed, the name of the party filing the document, and the name, mailing address, telephone number, fax number, if any, email address, and State Bar of Texas identification number of the lead counsel for the filing party. If a party requests oral argument in the court of appeals, the request must appear on the front cover of that party's first brief.

(h) *Appendix and Original Proceeding Record*. A paper appendix may be bound either with the document to which it is related or separately. If separately bound, the appendix must comply with paragraph (f). A paper record in an original proceeding or a paper appendix must be tabbed and indexed. An electronically filed record in an original proceeding or an electronically filed appendix that includes more than one item must contain bookmarks to assist in locating each item.

(i) *Length*.

(1) Contents Included and Excluded. In calculating the length of a document, every word and every part of the document, including headings, footnotes, and quotations, must be counted except the following: caption, identity of parties and counsel, statement

regarding oral argument, table of contents, index of authorities, statement of the case, statement of issues presented, **statement of error preservation,** statement of jurisdiction, statement of procedural history, signature, proof of service, certification, certificate of compliance, and appendix.

(2) Maximum Length. The documents listed below must not exceed the following limits:

(A) A brief and response in a direct appeal to the Court of Criminal Appeals in a case in which the death penalty has been assessed: 37,500 words if computer-generated, and 125 pages if not.

(B) A brief and response in an appellate court (other than a brief under subparagraph (A)) and a petition and response in an original proceeding in the court of appeals: 15,000 words if computer-generated, and 50 pages if not. In a civil case in the court of appeals, the aggregate of all briefs filed by a party must not exceed 27,000 words if computer-generated, and 90 pages if not.

(C) A reply brief in an appellate court and a reply to a response to a petition in an original proceeding in the court of appeals: 7,500 words if computer-generated, and 25 pages if not.

(D) A petition and response in an original proceeding in the Supreme Court, a petition for review and response in the Supreme Court, a petition for discretionary review in the Court of Criminal Appeals, and a motion for rehearing in an appellate court: 4,500 words if computer-generated, and 15 pages if not.

(E) A reply to a response to a petition for review in the Supreme Court, a reply to a response to a petition in an original proceeding in the Supreme Court, and a reply to a petition for discretionary review in the Court of Criminal Appeals: 2,400 words if computer-generated, and 8 pages if not.

(3) Certificate of Compliance. A computer-generated document that is subject to a word limit under this rule must include a certificate by counsel or an unrepresented party stating the number of words in the

document. The person certifying may rely on the word count of the computer program used to prepare the document.

(4) Extensions. A court may, on motion, permit a document that exceeds the prescribed limit.

(j) *Electronically Filed Documents.* An electronically filed document must:

(1) be in text-searchable portable document format (PDF);

(2) be directly converted to PDF rather than scanned, if possible;

(3) not be locked;

(4) be combined with any appendix into one computer file, unless that file would exceed the size limit prescribed by the electronic filing manager; and

(5) otherwise comply with the Technology Standards set by the Judicial Committee on Information Technology and approved by the Supreme Court.

(k) *Nonconforming Documents*. If a document fails to conform with these rules, the court may strike the document or identify the error and permit the party to resubmit the document in a conforming format by a specified deadline.

III. Brief Statement of Reasons for Proposed Amendment

The proposed revision is a companion to the proposed revision of Texas Rule of Appellate Procedure 38.1 and provides that a statement of error preservation is not included when calculating a document's length.

Respectfully submitted,

Carlos R. Soltero
Chair, State Bar Court Rules Committee
May 1, 2015

STATE BAR COURT RULES COMMITTEE

PROPOSED AMENDMENT TO TEXAS RULE OF APPELLATE PROCEDURE 38.1

I. Exact Language of Existing Rules

38.1. Appellant's Brief

The appellant's brief must, under appropriate headings and in the order here indicated, contain the following:

(a) *Identity of Parties and Counsel.* The brief must give a complete list of all parties to the trial court's judgment or order appealed from, and the names and addresses of all trial and appellate counsel, except as otherwise provided in Rule 9.8.

(b) *Table of Contents.* The brief must have a table of contents with references to the pages of the brief. The table of contents must indicate the subject matter of each issue or point, or group of issues or points.

(c) *Index of Authorities.* The brief must have an index of authorities arranged alphabetically and indicating the pages of the brief where the authorities are cited.

(d) *Statement of the Case.* The brief must state concisely the nature of the case (e.g., whether it is a suit for damages, on a note, or involving a murder prosecution), the course of proceedings, and the trial court's disposition of the case. The statement should be supported by record references, should seldom exceed one-half page, and should not discuss the facts.

(e) *Any Statement Regarding Oral Argument.* The brief may include a statement explaining why oral argument should or should not be permitted. Any such statement must not exceed one page and should address how the court's decisional process would, or would not, be aided by oral argument. As required by Rule 39.7, any party requesting oral argument must note that request on the front cover of the party's brief.

(f) *Issues Presented.* The brief must state concisely all issues or points presented for review. The statement of an issue or point will be treated as covering every subsidiary question that is fairly included.

(g) *Statement of Facts.* The brief must state concisely and without argument the facts pertinent to the issues or points presented. In a civil case, the court will accept as true the facts stated unless another party contradicts them. The statement must be supported by record references.

(h) *Summary of the Argument*. The brief must contain a succinct, clear, and accurate statement of the arguments made in the body of the brief. This summary must not merely repeat the issues or points presented for review.

(i) *Argument*. The brief must contain a clear and concise argument for the contentions made, with appropriate citations to authorities and to the record.

(j) *Prayer*. The brief must contain a short conclusion that clearly states the nature of the relief sought.

(k) *Appendix in Civil Cases*.

> (1) Necessary Contents. Unless voluminous or impracticable, the appendix must contain a copy of:
>
> > (A) the trial court's judgment or other appealable order from which relief is sought;
> >
> > (B) the jury charge and verdict, if any, or the trial court's findings of fact and conclusions of law, if any; and
> >
> > (C) the text of any rule, regulation, ordinance, statute, constitutional provision, or other law (excluding case law) on which the argument is based, and the text of any contract or other document that is central to the argument.
>
> (2) Optional Contents. The appendix may contain any other item pertinent to the issues or points presented for review, including copies or excerpts of relevant court opinions, laws, documents on which the suit was based, pleadings, excerpts from the reporter's record, and similar material. Items should not be included in the appendix to attempt to avoid the page limits for the brief.

II. Proposed Changes to Existing Rule

38.1. Appellant's Brief

The appellant's brief must, under appropriate headings and in the order here indicated, contain the following:

(a) *Identity of Parties and Counsel.* The brief must give a complete list of all parties to the trial court's judgment or order appealed from, and the names and addresses of all trial and appellate counsel, except as otherwise provided in Rule 9.8.

(b) *Table of Contents.* The brief must have a table of contents with references to the pages of the brief. The table of contents must indicate the subject matter of each issue or point, or group of issues or points.

(c) *Index of Authorities.* The brief must have an index of authorities arranged alphabetically and indicating the pages of the brief where the authorities are cited.

(d) *Statement of the Case.* The brief must state concisely the nature of the case (e.g., whether it is a suit for damages, on a note, or involving a murder prosecution), the course of proceedings, and the trial court's disposition of the case. The statement should be supported by record references, should seldom exceed one-half page, and should not discuss the facts.

(e) *Any Statement Regarding Oral Argument.* The brief may include a statement explaining why oral argument should or should not be permitted. Any such statement must not exceed one page and should address how the court's decisional process would, or would not, be aided by oral argument. As required by Rule 39.7, any party requesting oral argument must note that request on the front cover of the party's brief.

(f) *Issues Presented.* The brief must state concisely all issues or points presented for review. The statement of an issue or point will be treated as covering every subsidiary question that is fairly included.

(g) *Statement of Error Preservation.* For each issue presented for review, the brief must provide either

(1) citations, without argument, to the record showing that

(A) the complaint was made to the trial court by a timely request, objection, or motion;~~,~~ and

(B) the trial court

(i) ruled on the request, objection, or motion, either expressly or implicitly; or

(ii) refused to rule on the request, objection, or motion, and the complaining party objected to the refusal; or

(2) citations, without argument, to appropriate authority that the complaint was not required to be raised in the trial court.

<u>(h)</u> *Statement of Facts*. The brief must state concisely and without argument the facts pertinent to the issues or points presented. In a civil case, the court will accept as true the facts stated unless another party contradicts them. The statement must be supported by record references.

<u>(i)</u> *Summary of the Argument*. The brief must contain a succinct, clear, and accurate statement of the arguments made in the body of the brief. This summary must not merely repeat the issues or points presented for review.

<u>(j)</u> *Argument*. The brief must contain a clear and concise argument for the contentions made, with appropriate citations to authorities and to the record.

<u>(k)</u> *Prayer*. The brief must contain a short conclusion that clearly states the nature of the relief sought.

<u>*(l)*</u> *Appendix in Civil Cases*.

(1) Necessary Contents. Unless voluminous or impracticable, the appendix must contain a copy of:

(A) the trial court's judgment or other appealable order from which relief is sought;

(B) the jury charge and verdict, if any, or the trial court's findings of fact and conclusions of law, if any; and

(C) the text of any rule, regulation, ordinance, statute, constitutional provision, or other law (excluding case law) on which the argument is based, and the text of any contract or other document that is central to the argument.

(2) Optional Contents. The appendix may contain any other item pertinent to the issues or points presented for review, including copies or excerpts of relevant court opinions, laws, documents on which the suit was based, pleadings, excerpts from the reporter's record, and similar material. Items should not be included in the appendix to attempt to avoid the page limits for the brief.

III. Brief Statement of Reasons for Proposed Amendment

Preservation of error in the trial court is a prerequisite to appellate review of most complaints, but the rules of appellate procedure currently do not require the complaining party to provide citations to the record showing that a complaint was preserved. As a result, the appellate courts bear the burden of sifting the record to determine whether the complaint was raised and whether the trial court ruled on it. In the absence of an express ruling, the appellate court also must determine whether the trial court implicitly ruled. If the error was not preserved, then the time the attorney spent in briefing the issue, the money the client paid for the work, and the judicial resources expended in reading the argument, reviewing the record, and opining that the error was unpreserved all are wasted.

Because the party raising an appellate complaint is in the best position to know whether the error was preserved in the trial court, it would be both more efficient and more equitable to place the burden of showing that the prerequisites to appellate review have been satisfied on the party seeking the benefit of that review.

Respectfully submitted,

Carlos R. Soltero
Chair, State Bar Court Rules Committee
May 1, 2015

STATE BAR COURT RULES COMMITTEE

PROPOSED AMENDMENT TO TEXAS RULE OF APPELLATE PROCEDURE 38.2

I. Exact Language of Existing Rule

38.2. Appellee's Brief

(a) *Form of Brief.*

(1) An appellee's brief must conform to the requirements of Rule 38.1, except that:

(A) the list of parties and counsel is not required unless necessary to supplement or correct the appellant's list;

(B) the appellee's brief need not include a statement of the case, a statement of the issues presented, or a statement of facts, unless the appellee is dissatisfied with that portion of the appellant's brief; and

(C) the appendix to the appellee's brief need not contain any item already contained in an appendix filed by the appellant.

(2) When practicable, the appellee's brief should respond to the appellant's issues or points in the order the appellant presented those issues or points.

(b) *Cross-Points.*

(1) Judgment Notwithstanding the Verdict. When the trial court renders judgment notwithstanding the verdict on one or more questions, the appellee must bring forward by cross-point any issue or point that would have vitiated the verdict or that would have prevented an affirmance of the judgment if the trial court had rendered judgment on the verdict. Failure to bring forward by cross-point an issue or point that would vitiate the verdict or prevent an affirmance of the judgment waives that complaint. Included in this requirement is a point that:

(A) the verdict or one or more jury findings have insufficient evidentiary support or are against the overwhelming preponderance of the evidence as a matter of fact; or

(B) the verdict should be set aside because of improper argument of counsel.

(2) When Evidentiary Hearing Needed. The appellate court must remand a case to the trial court to take evidence if:

(A) the appellate court has sustained a point raised by the appellant; and

(B) the appellee raised a cross-point that requires the taking of additional evidence.

II. Proposed Changes to Existing Rule

38.2. Appellee's Brief

(a) *Form of Brief.*

(1) An appellee's brief must conform to the requirements of Rule 38.1, except that:

(A) the list of parties and counsel is not required unless necessary to supplement or correct the appellant's list;

(B) the appellee's brief need not include a statement of the case, a statement of the issues presented, or a statement of facts, unless the appellee is dissatisfied with that portion of the appellant's brief; ~~and~~

(C) the appellee's brief is required to include a statement of error preservation only as to issues brought forward by the appellee; and

(D) the appendix to the appellee's brief need not contain any item already contained in an appendix filed by the appellant.

(2) When practicable, the appellee's brief should respond to the appellant's issues or points in the order the appellant presented those issues or points.

(b) *Cross-Points.*

(1) Judgment Notwithstanding the Verdict. When the trial court renders judgment notwithstanding the verdict on one or more questions, the appellee must bring forward by cross-point any issue or point that would have vitiated the verdict or that would have prevented an affirmance of the judgment if the trial court had rendered judgment on the verdict. Failure to bring forward by cross-point an issue or point that would vitiate the verdict or prevent an

affirmance of the judgment waives that complaint. Included in this requirement is a point that:

> (A) the verdict or one or more jury findings have insufficient evidentiary support or are against the overwhelming preponderance of the evidence as a matter of fact; or
>
> (B) the verdict should be set aside because of improper argument of counsel.

(2) When Evidentiary Hearing Needed. The appellate court must remand a case to the trial court to take evidence if:

> (A) the appellate court has sustained a point raised by the appellant; and
>
> (B) the appellee raised a cross-point that requires the taking of additional evidence.

III. Brief Statement of Reasons for Proposed Amendment

The proposed revision is a companion to the proposed revision of Texas Rule of Appellate Procedure 38.1 and provides that a statement of error preservation must be included in an appellee's brief only if the appellee is complaining of error.

Respectfully submitted,

Carlos R. Soltero
Chair, State Bar Court Rules Committee
May 1, 2015

Tab T

To: Supreme Court Advisory Committee

From: Appellate Rule Subcommittee

Date: August 1, 2024

Re: Proposal Regarding Publication of Court of Appeals Opinion When Review is Granted

On July 17, 2024, the Texas Supreme Court referred the following matter for review and recommendation:

"Publishers like West do not publish memorandum opinions in civil cases by using a formal reporter citation reference or print them in bound volumes. Memorandum opinions are publicly available, however, and their citation is permitted under current rules by reference to an online reporter locator number. The Court's practice is to order publication of a court of appeals' memorandum opinion in cases in which the Court has granted review, thus giving those opinions a formal reporter citation reference. The Committee should advise whether the Court should require that court of appeals opinions be designated for formal publication when review is granted."

This matter was assigned to the Appellate Rules Subcommittee, which makes the following recommendation.

Before citation of memorandum opinions was formalized and Texas Rule of Appellate Procedure 47.3 was adopted, the distinction between "published" opinions appearing in the S.W.3d reporter and "unpublished" opinions appearing only online was a significant consideration with respect to a given opinion's precedential weight and authority. Since that time, widespread use of and access to online opinion reporting sources has diminished the importance of this distinction. Rule 47.3 describes criteria for appellate courts to use in deciding whether an opinion should be designated for inclusion in the S.W.3d reporter or, instead, designated as a memorandum opinion. As a practical matter, the formality and contents of "published" opinions appearing in the S.W.3d reporter and "memorandum" opinions often are similar. Courts and advocates frequently cite both types of opinions interchangeably, and treat them as having equivalent weight.

The referred matter does not encompass larger questions regarding whether (1) the distinction between "published" and "unpublished" opinions should be maintained, or (2) the criteria for designating an opinion as a "memorandum opinion" should be revisited.

The subcommittee recommends that, so long as the distinction between formal "published" opinions and "memorandum" opinions is maintained in the rules, the Texas Supreme Court should require that court of appeals opinions be designated for formal publication when review is granted. This procedure comports with the statutory important-to-the-jurisprudence criterion for granting review. Under the current Rule 47.3 standards for designation of a "memorandum opinion," inclusion of an opinion in the S.W.3d reporter is an indication that an opinion addresses issues important to Texas jurisprudence. Inclusion in the official reporter also may marginally increase ease of access to the opinion. For these reasons, the Court's practice should continue.

Tab U

MEMORANDUM

TO: Supreme Court Advisory Committee

FROM: Appellate Subcommittee

DATE: October 29, 2024

RE: Proposed Amendments to Texas Rule of Appellate Procedure 18.1(a)

The Texas Supreme Court has asked the Advisory Committee to study and make a recommendation with respect to a proposal by the State Bar Court Rules Committee to amend Texas Rule of Appellate Procedure 18.1(a) to clarify when a court of appeals must issue its mandate. *See* **Exhibit A**.

As set forth in the statement of reasons for the proposed amendment, the proposal stems from the following concern. Rule 18.1(a) sets forth several scenarios involving the timing of when a court of appeals must issue its mandate. "But Rule 18.1(a) is silent about when a court of appeals must issue its mandate for a number of other common scenarios—leading to confusion among members of the bench and bar." *See id.* at 6. The identified scenarios are for which the rule is silent are as follows.

- A petition for review or for discretionary review has been granted but is later set aside.
- A motion for extension of time is on file when the deadline arises but the extension is subsequently denied.
- A motion for rehearing of a denial, refusal, or dismissal is denied without opinion by the Supreme Court or the Court of Criminal Appeals, meaning that no further motion for rehearing can be filed.

See id. Additionally, the State Bar's proposed amendment is "intended to clarify the rule by categorizing the deadlines to issue the mandate by whether a party has or has not filed something in subsections (a)(1) and (a)(2)."

The Appellate Subcommittee's recommendation is that a re-organization of Rule 18.1(a) is not warranted along the lines of whether a filing has or has not been made. The existing Rule 18.1 dates to 1997, and was amended effective January 1, 2003; during that time, courts and attorneys have not indicated that the format or structure of Rule 18.1(a) is causing widespread confusion. Therefore, the Appellate Subcommittee does not recommend restructuring the rule or changing its format. If there are concerns that particular scenarios are not expressly referenced, then any such gap can be addressed by adding subsections to existing Rule 18.1(a) as set forth below.

Here is a proposed revision addressing the three scenarios identified by the State Bar Rules Committee.

Rule 18 Mandate

18.1 Issuance

The clerk of the appellate court that rendered the judgment must issue a mandate in accordance with the judgment and send it to the clerk of the court to which it is directed and to all parties to the proceedings when one of the following periods expires:

(a) *In the Court of Appeals*.

(1) Ten days after the time has expired for filing a motion to extend time to file a petition for review or a petition for discretionary review if:

(A) no timely petition for review or petition for discretionary review has been filed;

(B) no timely filed motion to extend time to file a petition for review or petition for discretionary review is pending; and

(C) in a criminal case, the Court of Criminal Appeals has not granted review on its own initiative.

(2) Ten days after the time has expired for filing a motion to extend time to file a motion for rehearing of a denial, refusal, or dismissal of a petition for review, or a refusal or dismissal of a petition for discretionary review, if no timely filed motion for rehearing or motion to extend time is pending.

(3) Ten days after a motion for rehearing of a denial, refusal, or dismissal of a petition for review or petition for discretionary review is denied without opinion.

(4) Ten days after the Supreme Court or Court of Criminal Appeals sets aside a petition for review or petition for discretionary review after it has been granted.

(5) Ten days after denial of a motion for extension of time that is on file when the deadline arises for the petition for review or petition for discretionary review.

Tab V

STATE BAR OF TEXAS COURT RULES COMMITTEE
PROPOSED AMENDMENT TO
TEXAS RULE OF APPELLATE PROCEDURE 18.1(a)

I. Exact Language of Existing Rule 18

Rule 18. Mandate

18.1. Issuance

The clerk of the appellate court that rendered the judgment must issue a mandate in accordance with the judgment and send it to the clerk of the court to which it is directed and to all parties to the proceeding when one of the following periods expires:

(a) *In the Court of Appeals.*

(1) Ten days after the time has expired for filing a motion to extend time to file a petition for review or a petition for discretionary review if:

(A) no timely petition for review or petition for discretionary review has been filed;

(B) no timely filed motion to extend time to file a petition for review or petition for discretionary review is pending; and

(C) in a criminal case, the Court of Criminal Appeals has not granted review on its own initiative.

(2) Ten days after the time has expired for filing a motion to extend time to file a motion for rehearing of a denial, refusal, or dismissal of a petition for review, or a refusal or dismissal of a petition for discretionary review, if no timely filed motion for rehearing or motion to extend time is pending.

(b) *In the Supreme Court and the Court of Criminal Appeals.* Ten days after the time has expired for filing a motion to extend time to file a motion for rehearing if no timely filed motion for rehearing or motion to extend time is pending.

(c) *Agreement to Issue.* The mandate may be issued earlier if the parties so agree, or for good cause on the motion of a party.

18.2. Stay of Mandate

A party may move to stay issuance of the mandate pending the United States Supreme Court's disposition of a petition for writ of certiorari. The motion must state the grounds for the petition and the circumstances requiring the stay. The appellate court authorized to issue the mandate may grant a stay if it finds that the grounds are substantial and that the petitioner or others would incur serious hardship from the mandate's issuance if the United States Supreme Court were later to reverse the judgment. In a criminal case, the stay will last for no more than 90 days, to permit the timely filing of a petition for writ of certiorari. After that period and others mentioned in this rule expire, the mandate will issue.

18.3. Trial Court Case Number

The mandate must state the trial court case number.

18.4. Filing of Mandate

The clerk receiving the mandate will file it with the case's other papers and note it on the docket.

18.5. Costs

The mandate will be issued without waiting for costs to be paid. If the Supreme Court declines to grant review, Supreme Court costs must be included in the court of appeals' mandate.

18.6. Mandate in Accelerated Appeals

The appellate court's judgment on an appeal from an interlocutory order takes effect when the mandate is issued. The court may issue the mandate with its judgment or delay the mandate until the appeal is finally disposed of. If the mandate is issued, any further proceeding in the trial court must conform to the mandate.

18.7. Recall of Mandate

If an appellate court vacates or modifies its judgment or order after issuing its mandate, the appellate clerk must promptly notify the clerk of the court to which the mandate was directed and all parties. The mandate will have no effect and a new mandate may be issued.

Notes and Comments

Comment to 1997 change: This is a new rule that combines the provisions of former Rules 43(g), 86, 186, 231, and 232.

Comment to 2002 change: Subdivision 18.1 is amended consistent with the change in subdivision 12.6.

II. Proposed Amendment to Existing Rule 18.1(a)

Rule 18. Mandate

18.1. Issuance

The clerk of the appellate court that rendered the judgment must issue a mandate in accordance with the judgment and send it to the clerk of the court to which it is directed and to all parties to the proceeding when one of the following periods expires:

(a) *In the Court of Appeals*.

~~(1) Ten days after the time has expired for filing a motion to extend time to file a petition for review or a petition for discretionary review if:~~

~~(A) no timely petition for review or petition for discretionary review has been filed;~~

~~(B) no timely filed motion to extend time to file a petition for review or petition for discretionary review is pending; and~~

~~(C) in a criminal case, the Court of Criminal Appeals has not granted review on its own initiative.~~

~~(2) Ten days after the time has expired for filing a motion to extend time to file a motion for rehearing of a denial, refusal, or dismissal of a petition for review, or a refusal or dismissal of a petition for discretionary review, if no timely filed motion for rehearing or motion to extend time is pending.~~

(1) If no party has filed:

(A) a petition for review or petition for discretionary review, ten days after the time has expired to file a motion for extension of time for such petition; or

(B) a motion for extension of time to file a motion for rehearing of a denial, refusal, or dismissal of a petition for review or petition for discretionary review, ten days after the time has expired to file such motion for extension of time.

(2) If a party has filed:

(A) a motion for extension of time to file a petition for review, petition for discretionary review, or motion for rehearing of a denial, refusal, or dismissal of a petition for review or petition for discretionary review, ten days after such motion is denied; or

(B) a motion for rehearing of a denial, refusal, or dismissal of a petition for review or petition for discretionary review, ten days after such denial if denied without opinion.

(3) In a criminal case, if no party has filed a petition for discretionary review, or a motion for extension of time to file such petition, and the Court of Criminal Appeals has not granted review on its own initiative, ten days after the time has expired to file a motion for extension of time for such petition.

(4) If the Supreme Court or Court of Criminal Appeals sets aside a petition for review or petition for discretionary review, ten days from the date the petition for review or petition for discretionary review is set aside.

(b) *In the Supreme Court and the Court of Criminal Appeals*. Ten days after the time has expired for filing a motion to extend time to file a motion for rehearing if no timely filed motion for rehearing or motion to extend time is pending.

(c) *Agreement to Issue*. The mandate may be issued earlier if the parties so agree, or for
good cause on the motion of a party.

18.2. Stay of Mandate

A party may move to stay issuance of the mandate pending the United States Supreme Court's disposition of a petition for writ of certiorari. The motion must state the grounds for the petition and the circumstances requiring the stay. The appellate court authorized to issue the mandate may grant a stay if it finds that the grounds are substantial and that the petitioner or others would incur serious hardship from the mandate's issuance if the United States Supreme Court were later to reverse the judgment. In a criminal case, the stay will last for no more than 90 days, to permit the timely filing of a petition for writ of certiorari. After that period and others mentioned in this rule expire, the mandate will issue.

18.3. Trial Court Case Number

The mandate must state the trial court case number.

18.4. Filing of Mandate

The clerk receiving the mandate will file it with the case's other papers and note it on the docket.

18.5. Costs

The mandate will be issued without waiting for costs to be paid. If the Supreme Court declines to grant review, Supreme Court costs must be included in the court of appeals' mandate.

18.6. Mandate in Accelerated Appeals

The appellate court's judgment on an appeal from an interlocutory order takes effect when the mandate is issued. The court may issue the mandate with its judgment or delay the mandate until the appeal is finally disposed of. If the mandate is issued, any further proceeding in the trial court must conform to the mandate.

18.7. Recall of Mandate

If an appellate court vacates or modifies its judgment or order after issuing its mandate, the appellate clerk must promptly notify the clerk of the court to which the mandate was directed and all parties. The mandate will have no effect and a new mandate may be issued.

Notes and Comments

Comment to 1997 change: This is a new rule that combines the provisions of former Rules 43(g), 86, 186, 231, and 232.

Comment to 2002 change: Subdivision 18.1 is amended consistent with the change in subdivision 12.6.

Comment to Proposed Change: Subsection (a) of Rule 18.1 is revised to clarify when the mandate should issue from a court of appeals.

III. Brief Statement of Reasons for the Requested Amendments and Advantages Served by Them

Rule 18.1(a) provides when a court of appeals must issue its mandate. The current rule addresses several different scenarios that include: if no timely petition for review or petition for discretionary review has been filed; no timely motion for extension of time to file a petition for review or petition for discretionary review has been filed; the court of criminal appeals has not granted review on its own initiative; and, if no timely filed motion for rehearing or motion to extend time is pending, if the time has expired for filing a motion to extend time to file a motion for rehearing of a denial, refusal, or refusal or dismissal of a petition for review or refusal of a petition for discretionary review.

But Rule 18.1(a) is silent about when a court of appeals must issue its mandate for a number of other common scenarios—leading to confusion among members of the bench and bar. Those scenarios include if: a petition for review or petition for discretionary review has been granted but is later set aside; if a motion for extension of time is on file when the deadline for it arises but is subsequently denied; or if a motion for rehearing of a denial, refusal, or dismissal is denied without opinion by the Supreme Court or Court of Criminal Appeals, meaning that no further motion for rehearing can be filed.

The purpose of this amendment is to clarify and address these additional common scenarios and thus provide needed certainty to this rule. This amendment is also intended to clarify the rule by categorizing the deadlines to issue the mandate by whether a party has or has not filed something in subsections (a)(1) and (a)(2).

Tab W

The Supreme Court of Texas

CHIEF JUSTICE
NATHAN L. HECHT

JUSTICES
DEBRA H. LEHRMANN
JEFFREY S. BOYD
JOHN P. DEVINE
JAMES D. BLACKLOCK
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DIRECTOR OF PUBLIC AFFAIRS
AMY STARNES

September 16, 2024

Mr. Charles L. “Chip” Babcock
Chair, Supreme Court Advisory Committee
Jackson Walker L.L.P.
cbabcock@jw.com

Re: Referral of Rules Issue

Dear Chip:

The Supreme Court requests the Advisory Committee to study and make recommendations on the following matters.

Procedural Rules for the State Commission on Judicial Conduct. The Procedural Rules for the State Commission on Judicial Conduct do not reflect recent statutory changes, including changes enacted by the 87th Legislature in HB 4344, and, in some instances, are unclear or unworkable. The Court asks the Committee to conduct a wholesale review of the Procedural Rules for the State Commission on Judicial Conduct and draft amendments for the Court’s consideration.

As always, the Court is grateful for the Committee’s counsel and your leadership.

Sincerely,

Nathan L. Hecht
Chief Justice

Attachment

AN ACT

relating to a complaint filed with the State Commission on Judicial Conduct.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF TEXAS:

SECTION 1. Section 33.0211, Government Code, is amended by adding Subsection (c) to read as follows:

(c) For each complaint filed with the commission under this chapter, each member of the commission must be:

(1) notified of the complaint; and

(2) briefed and provided detailed information about the complaint.

SECTION 2. Subchapter B, Chapter 33, Government Code, is amended by adding Sections 33.0212, 33.0213, 33.040, and 33.041 to read as follows:

Sec. 33.0212. REPORT AND RECOMMENDATIONS ON FILED COMPLAINTS. (a) Not later than the 120th day after the date a complaint is filed with the commission, commission staff shall prepare and file with each member of the commission a report detailing the investigation of the complaint and recommendations for commission action regarding the complaint.

(b) Not later than the 90th day following the date commission staff files with the commission the report required by Subsection (a), the commission shall determine any action to be taken regarding the complaint, including:

(1) a public sanction;

(2) a private sanction;

(3) a suspension;

(4) an order of education;

(5) an acceptance of resignation in lieu of discipline;

(6) a dismissal; or

(7) an initiation of formal proceedings.

(c) If, because of extenuating circumstances, commission staff is unable to provide an investigation report and recommendation to the commission before the 120th day following the date the complaint was filed with the commission, the staff shall notify the commission and propose the number of days required for the commission and commission staff to complete the investigation report and recommendations and finalize the complaint. The staff may request an extension of not more than 270 days from the date the complaint was filed with the commission. The commission shall finalize the complaint not later than the 270th day following the date the complaint was filed with the commission.

(d) The executive director may request that the chairperson grant an additional 120 days to the time provided under Subsection (c) for the commission and commission staff to complete the investigation report and recommendations and finalize the complaint.

(e) If the chairperson grants additional time under Subsection (d), the commission must timely inform the legislature of the extension. The commission may not disclose to the legislature any confidential information regarding the complaint.

Sec. 33.0213. NOTIFICATION OF LAW ENFORCEMENT AGENCY INVESTIGATION. On notice by any law enforcement agency investigating an action for which a complaint has been filed with the commission, the commission may place the commission's complaint file on hold and decline any further investigation that would jeopardize the law enforcement agency's investigation. The commission may continue an investigation that would not jeopardize a law enforcement investigation.

Sec. 33.040. ANNUAL REPORT. Not later than September 1 of each year, the commission shall prepare and submit to the legislature a report of:

(1) the total number of complaints the commission failed to finalize not later than the 270th day following the date the complaint was filed with the commission; and

(2) the total number of complaints included in Subdivision (1) that the commission declined to further investigate because of a law enforcement agency investigation.

Sec. 33.041. LEGISLATIVE REPORT. (a) The commission shall prepare a report for the 88th Legislature regarding any statutory changes that would improve the commission's effectiveness, efficiency, and transparency in filing, investigating, and processing any complaint filed with the commission.

(b) This section expires September 1, 2023.

SECTION 3. Section 33.0212, Government Code, as added by this Act, applies only to a complaint filed with the State Commission on Judicial Conduct on or after the effective date of this Act.

SECTION 4. This Act takes effect September 1, 2022.

President of the Senate

Speaker of the House

I certify that H.B. No. 4344 was passed by the House on April 27, 2021, by the following vote: Yeas 147, Nays 0, 1 present, not voting; and that the House concurred in Senate amendments to H.B. No. 4344 on May 28, 2021, by the following vote: Yeas 147, Nays 0, 1 present, not voting.

Chief Clerk of the House

I certify that H.B. No. 4344 was passed by the Senate, with amendments, on May 25, 2021, by the following vote: Yeas 31, Nays 0.

Secretary of the Senate

APPROVED: ____________________

Date

____

Governor

Tab X

MEMORANDUM

TO: Supreme Court Advisory Committee

FROM: Judicial Administration Subcommittee

DATE: October 31, 2024

RE: Revisions to Procedural Rules for the State Commission on Judicial Conduct

---

The Texas Supreme Court has asked the Advisory Committee to "conduct a wholesale review of the Procedural Rules for the State Commission on Judicial Conduct and draft amendments for the Court's consideration." This review is requested because the rules "do not reflect recent statutory changes, including changes enacted by the 87th Legislature in HB 4344, and, in some instances, are unclear or unworkable."

The current rules are attached as **Exhibit A**. The referral and HB 4344 are attached as **Exhibit B**. The Commission's most recent legislative report is attached as **Exhibit C**.

Overview

This initial memo focuses on proposed amendments necessary to conform the rules to HB 4344's requirements.

Additional proposed rule amendments will be addressed in subsequent memos. Potential areas for future proposed rule amendments include clarification of terminology used in Rule 3; establishment of a deadline for completion of a preliminary investigation under Rule 3 to promote the quick resolution of baseless complaints; clarification of terminology in Rule 4; clarification of procedures under Rule 10, and how "formal proceedings" differ from a "full investigation"; and clarification of circumstances under which proceedings may be expedited. Others may be suggested.

In conjunction with this referral, the Judicial Administration Subcommittee has been in communication with and solicited input on potential rule changes from several sources, including Commission staff; the Judicial Section of the State Bar of Texas; legislative staff; and the Texas District Judges Association. The subcommittee invites input on proposed rule changes from all interested persons and organizations.

Additional legislation affecting the Commission’s operations likely will be introduced during the upcoming session. If passed and signed into law, such legislation may necessitate additional rule revisions.

Any discussion of rule changes must take into account the crucial interests that are bound up in the Commission’s constitutional mandate to investigate and address allegations of misconduct or permanent disability with respect to judges and judicial candidates. Some allegations are baseless, and some are not. The process for evaluating and addressing them must be based on accountability; fair to persons who make allegations of misconduct or disability; fair to judges and judicial candidates against whom allegations are made; fair to litigants, lawyers, and justice-involved individuals whose interests are implicated by such allegations; and grounded in the importance of protecting public confidence in the integrity of the judiciary and court system.

Against this backdrop, the subcommittee has examined proposed rule changes necessary to implement deadlines and other procedures required by statute.

Proposed rule changes to implement HB 4344

HB 4344 was passed during the 87th Legislature and signed into law by Governor Abbott on June 15, 2021. It took effect on September 1, 2022. Among other things, HB 4344 amended Chapter 33 of the Government Code to create deadlines for action on complaints filed with the Commission.

As currently structured, Rule 3(a) provides for conducting a “Preliminary Investigation” by the Commission upon receipt of a verified statement, upon its own motion, “or otherwise” as is “appropriate to the circumstances relating to an allegation or appearance of misconduct or disability of any judge or judicial candidate to determine that such allegation or appearance is neither unfounded nor frivolous.” Under Rule 3(b), “if the preliminary investigation discloses that the allegation or appearance is unfounded or frivolous, the Commission shall terminate further proceedings.”

Rule 4(a) provides that the Commission “shall conduct a full investigation into the matter” if the preliminary investigation discloses that

- “the allegations or appearances are neither unfounded nor frivolous”;
- “sufficient cause exists to warrant full inquiry into the facts and circumstances indicating that a judge or judicial candidate may be guilty of willful or persistent conduct which is clearly inconsistent with the proper performance of his duties or casts public discredit upon the judiciary or the administration of justice”; or
- the judge “has a disability seriously interfering with the performance of his duties, which is, or is likely to become, permanent in nature ….”

Under Rule 4(b), the Commission “shall inform the judge or judicial candidate in writing that an investigation has commenced and of the nature of the matters being investigated.” Under Rule 9, a judge or judicial candidate who has received a sanction from the Commission may request the appointment of a Special Court of Review to challenge a Commission sanction determination. Rule 10 provides for “Formal Proceedings” if “after the investigation has been completed the Commission concludes that formal proceedings should be instituted.” Under Rule 11, the Commission must “promptly file a copy of a request for appointment of a Review Tribunal with the clerk of the Supreme Court” upon “making a determination to recommend the removal or retirement of a judge ….” Rule 13 allows a judge to appeal a decision of the Review Tribunal to the Supreme Court under the substantial evidence rule. Rule 15 allows the Commission to suspend a judge from office with or without pay “immediately upon being indicted by a state or federal grand jury for a felony offense or charged with a misdemeanor involving official misconduct.”

HB 4344 added new procedures and deadlines to Chapter 33 of the Government Code governing the Commission’s activities.

- It added subsection 33.0211(c) requiring that, for each complaint filed with the Commission, each member of the Commission must be notified of the complaint and “briefed and provided detailed information about the complaint.”
- It added section 33.0212 setting deadlines for (1) the Commission’s staff to file with each member of the Commission a report detailing the investigation of the complaint and recommendations for commission action regarding the complaint; and (2) the Commission to determine any action to be taken regarding the complaint.

- It added section 33.0213 allowing the Commission, upon notice by any law enforcement agency investigating an action for which a complaint has been filed with the Commission, to place the Commission's complaint file on hold and decline any further investigation that would jeopardize the law enforcement agency's investigation.

HB 4344 also created legislative reporting requirements for the Commission that are not procedural requirements needing to be reflected in the rules.

The deadlines and procedures reflected in HB 4344 do not distinguish between allegations that are addressed via a "Preliminary Investigation" under Rule 3 and those that are addressed via a "Full Investigation" under Rule 4. Accordingly, the subcommittee proposes adding new stand-alone rules incorporating HB 4344's deadlines and procedures—as opposed to suggesting additions or amendments to the existing Rules 1 through 18.

The proposed rule additions are as follows based upon HB 4344's language.

RULE ___. NOTIFICATION TO COMMISSIONERS OF COMPLAINT

Each member of the Commission must be notified of each complaint filed with the Commission,[1] and must be briefed and provided with detailed information about the complaint.

RULE ___. REPORT AND RECOMMENDATIONS ON FILED COMPLAINTS

(a) Not later than the 120th day after the date a complaint is filed[2] with the Commission, Commission staff shall prepare and file with each member of the Commission a report detailing the investigation of the complaint and recommendations for Commission action regarding the complaint.

---

[1] This language is taken verbatim from HB 4344 and is used elsewhere in Chapter 33. Consider how this "complaint filed with the Commission" language meshes with existing Rules 3 and 4, which (1) do not reference the filing of a "complaint," and (2) allow an investigation to be instituted based upon the Commission's own motion "or otherwise."

[2] *See* prior footnote regarding potential disconnect with language in current rules based upon a reference to filing a "complaint."

(b) Not later than the 90th day following the date on which Commission staff files with the Commission the report and recommendation required by Rule ___(a), the Commission shall determine any action to be taken regarding the complaint, including:

(1) a public sanction;

(2) a private sanction;

(3) a suspension;

(4) an order of education;

(5) an acceptance of resignation in lieu of discipline;

(6) a dismissal; or

(7) an initiation of formal proceedings.

(c) Upon a showing of extenuating circumstances that make compliance with Rule ___(a)'s 120-day deadline infeasible, Commission staff may request from the Commission members an extension of not more than 270 days from the date the complaint was filed with the Commission within which to file the report and recommendations required by Rule ___(a). The Commission shall finalize the complaint not later than the 270th day following the date the complaint was filed with the Commission.

(d) The Commission's executive director may request that the Commission's chairperson grant an additional 120 days to the time provided under Rule ___(c) for the Commission and Commission staff to complete the report and recommendations and finalize the complaint.

(e) If the Commission's chairperson grants additional time under Rule ___(d), the Commission must timely inform the Legislature of the extension. The Commission may

> not disclose to the Legislature any confidential information regarding the complaint.[3]
>
> **RULE ___. NOTIFICATION OF LAW ENFORCEMENT AGENCY**
>
> On notice by any law enforcement agency investigating an action for which a complaint has been filed with the Commission, the Commission may place the complaint on hold and decline any further investigation that would jeopardize the law enforcement agency's investigation. The Commission may continue an investigation that would not jeopardize a law enforcement investigation.

As noted above, there are multiple disconnects between (1) the statutory language used in HB 4344 and Chapter 33; and (2) the terminology used in the existing rules. Fully integrating HB 4344's requirements into the rules will require consideration of wider rule amendments, including potential amendments to the definitions in Rule 1 and to the procedures for initiating a matter at the Commission.

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[3] Does this legislative reporting requirement need to be in the rules?

Tab Y

PROCEDURAL RULES FOR THE STATE COMMISSION ON JUDICIAL CONDUCT

(Adopted and Promulgated Pursuant to Article V, Section 1-a(11), Texas Constitution)

RULE 1. DEFINITIONS

In these rules, unless the context or subject matter otherwise requires:

(a) "Commission" means the State Commission on Judicial Conduct.

(b) "Judge" means any Justice or Judge of the Appellate Courts and District and Criminal District Courts; any County Judge; any Judge of a County Court-at-Law, a Probate Court, or a Municipal Court; any Justice of the Peace; any Judge or presiding officer of any special court created by the Legislature; any retired judge or former judge who continues as a judicial officer subject to assignment to sit on any court of the state; and, any Master or Magistrate appointed to serve a trial court of this state.

(c) "Judicial Candidate" means any person seeking election as Chief Justice or Justice of the Supreme Court; Presiding Judge or Judge of the Court of Criminal Appeals; Chief Justice or Justice of a Court of Appeals; Judge of a District Court; Judge of a Statutory County Court; or Judge of a Statutory Probate Court.

(d) "Chairperson" includes the acting Chairperson of the Commission.

(e) "Special Master" means an individual appointed by the Supreme Court upon request of the Commission pursuant to Article V, Section 1-a, Paragraph (8) of the Texas Constitution.

(f) "Sanction" means any admonition, warning, reprimand, or requirement that the person obtain additional training or education, issued publicly or privately, by the Commission pursuant to the provisions of Article V, Section 1-a, Paragraph (8) of the Texas Constitution. A sanction is remedial in nature. It is issued prior to the institution of formal proceedings to deter similar misconduct by a judge or judicial candidate in the future, to promote proper administration of justice, and to reassure the public that the judicial system of this state neither permits nor condones misconduct.

(g) "Censure" means an order issued by the Commission pursuant to the provisions of Article V, Section 1-a, Paragraph (8) of the Texas Constitution or an order issued by a Review Tribunal pursuant to the provisions of Article V, Section 1-a, Paragraph (9) of the Texas Constitution. An order of censure is tantamount to denunciation of the offending conduct, and is more severe than the remedial sanctions issued prior to a formal hearing.

(h) "Special Court of Review" means a panel of three court of appeals justices selected by lot by the Chief Justice of the Supreme Court on petition, to review a censure or sanction issued by the Commission.

(i) "Review Tribunal" means a panel of seven court of appeals justices selected by lot by the Chief Justice of the Supreme Court to review the Commission's recommendation for the removal or retirement of a judge as provided in Article V, Section 1-a, Paragraph (9) of the Texas Constitution.

(j) "Formal Proceeding" means the proceedings ordered by the Commission concerning the possibility of a public censure of a judge or judicial candidate or the removal or retirement of a judge.

(k) "Examiner" means the person, including appropriate Commission staff or Special Counsel, appointed by the Commission to gather and present evidence before a special master, or the Commission, a Special Court of Review or a Review Tribunal.

(l) "Shall" is mandatory and "may" is permissive.

(m) "Mail" means First Class United States Mail.

(n) The masculine gender includes the feminine gender.

RULE 2. MAILING OF NOTICES AND OF OTHER MATTER

Whenever these rules provide for giving notice or sending any matter to a judge or judicial candidate, the same shall, unless otherwise expressly provided by the rules or requested in writing by the judge or judicial candidate, be sent to him by mail at his office or last known place of residence; provided, that when the judge or judicial candidate has a guardian or guardian ad litem, the notice or matter shall be sent to the guardian or guardian ad litem by mail at his office or last known place of residence.

RULE 3. PRELIMINARY INVESTIGATION

(a) The Commission may, upon receipt of a verified statement, upon its own motion, or otherwise, make such preliminary investigation as is appropriate to the circumstances relating to an allegation or appearance of misconduct or disability of any judge or judicial candidate to determine that such allegation or appearance is neither unfounded nor frivolous.

(b) If the preliminary investigation discloses that the allegation or appearance is unfounded or frivolous, the Commission shall terminate further proceedings.

RULE 4. FULL INVESTIGATION

(a) If the preliminary investigation discloses that the allegations or appearances are neither unfounded nor frivolous, or if sufficient cause exists to warrant full inquiry into the facts and circumstances indicating that a judge or judicial candidate may be guilty of willful or persistent conduct which is clearly inconsistent with the proper performance of his duties or casts public discredit upon the judiciary or the administration of justice, or that he has a disability seriously interfering with the performance of his duties, which is, or is likely to become, permanent in nature, the Commission shall conduct a full investigation into the matter.

(b) The Commission shall inform the judge or judicial candidate in writing that an investigation has commenced and of the nature of the matters being investigated.

(c) The Commission may request the judge's or judicial candidate's response in writing to the matters being investigated.

RULE 5. ISSUANCE, SERVICE, AND RETURN OF SUBPOENAS

(a) In conducting an investigation, formal proceedings, or proceedings before a Special Court of Review, the Chairperson or any member of the Commission, or a special master when a hearing is being conducted before a special master, or member of a Special Court of Review, may, on his own motion, or on request of appropriate Commission staff, the examiner, or the judge or judicial candidate, issue a subpoena for attendance of any witness or witnesses who may be represented to reside within the State of Texas.

(b) The style of the subpoena shall be "The State of Texas". It shall state the style of the proceeding, that the proceeding is pending before the Commission, the time and place at which the witness is required to appear, and the person or official body at whose instance the witness is summoned. It shall be signed by the Chairperson or some other member of the Commission, or by the special master when a hearing is before the special master, and the date of its issuance shall be noted thereon. It shall be addressed to any peace officer of the State of Texas or to a person designated by the Chairperson to make service thereof.

(c) A subpoena may also command the person to whom it is directed to produce the books, papers, documents or tangible things designated therein.

(d) Subpoenas may be executed and returned at any time, and shall be served by delivering a copy of such subpoena to the witness; the person serving the subpoena shall make due return thereof, showing the time and manner of service, or service thereof may be accepted by any witness by a written memorandum, signed by such witness, attached to the subpoena.

RULE 6. INFORMAL APPEARANCE

(a) Before terminating an investigation, the Commission may offer a judge or judicial candidate an opportunity to appear informally before the Commission.

(b) An informal appearance is confidential except that the judge or judicial candidate may elect to have the appearance open to the public or to any person or persons designated by the judge or judicial candidate. The right to an open appearance does not preclude placing of witnesses under the rule as provided by Rule 267 of the Texas Rules of Civil Procedure.

(c) No oral testimony other than the judge's or judicial candidate's shall be received during an informal appearance, although documentary evidence may be received. Testimony of the judge or judicial candidate shall be under oath, and a recording of such testimony taken. A copy of such recording shall be furnished to the judge or judicial candidate upon request.

(d) The judge or judicial candidate may be represented by counsel at the informal appearance.

(e) Notice of the opportunity to appear informally before the Commission shall be given by mail at least ten (10) days prior to the date of the scheduled appearance.

RULE 7. COMMISSION VOTING

A quorum shall consist of seven (7) members. Proceedings shall be by majority vote of those present, except that recommendations for retirement, censure, suspension or removal of any Judge shall be by affirmative vote of at least seven (7) members.

RULE 8. RESERVED FOR FUTURE PROMULGATION

RULE 9. REVIEW OF COMMISSION DECISION

(a) A judge or judicial candidate who has received from the Commission a sanction in connection with a complaint filed subsequent to September 1, 1987, may file with the Chief Justice of the Supreme Court a written request for appointment of a Special Court of Review, not later than the 30th day after the date on which the Commission issued its sanction.

(b) Within 15 days after appointment of the Special Court of Review, the Commission shall furnish the petitioner and each justice on the Special Court of Review a charging document which shall include a copy of the sanction issued as well as any additional charges to be considered in the de novo proceeding and the papers, documents, records, and evidence upon which the Commission based its decision. The sanction and other records filed with the Special Court of Review are public information upon filing with the Special Court of Review.

(c) Within 30 days after the date upon which the Commission files the charging document and related materials with the Special Court of Review, the Special Court of Review shall conduct a hearing. The Special Court of Review may, if good cause is shown, grant one or more continuances not to exceed a total of 60 days. The procedure for the hearing shall be governed by the rules of law, evidence, and procedure that apply to civil actions, except the judge or judicial candidate is not entitled to trial by jury, and the Special Court of Review's decision shall not be appealable. The hearing shall be held at a location determined by the Special Court of Review, and shall be public.

(d) Decision by the Special Court of Review may include dismissal, affirmation of the Commission's decision, imposition of a lesser or greater sanction, or order to the Commission to file formal proceedings.

(e) The opinion by the Special Court of Review shall be published if, in the judgment of a majority of the justices participating in the decision, it is one that (1) establishes a new rule of ethics or law, alters or modifies an existing rule, or applies an existing rule to a novel fact situation likely to recur in future cases; (2) involves a legal or ethical issue of continuing public interest; (3) criticizes existing legal or ethical principles; or (4) resolves an apparent conflict of authority. A concurring or dissenting opinion may be published if, in the judgment of its author, it meets one of the above indicated criteria, but in such event the majority opinion shall be published as well.

RULE 10. FORMAL PROCEEDINGS

(a) NOTICE

(1) If after the investigation has been completed the Commission concludes that formal proceedings should be instituted, the matter shall be entered in a docket to be kept for that purpose and written notice of the institution of formal proceedings shall be issued to the judge or judicial candidate without delay. Such proceedings shall be entitled:

> "Before the State Commission on Judicial Conduct Inquiry Concerning a Judge or Judicial Candidate, No. ______"

(2) The notice shall specify in ordinary and concise language the charges against the judge or judicial candidate, and the alleged facts upon which such charges are based and the specific standards contended to have been violated, and shall advise the judge or judicial candidate of his right to file a written answer to the charges against him within 15 days after service of the notice upon him.

(3) The notice shall be served by personal service of a copy thereof upon the judge or judicial candidate by a member of the Commission or by some person designated by the Chairperson, and the person serving the notice shall promptly notify the Commission in writing of the date on which the same was served. If it appears to the Chairperson upon affidavit that, after reasonable effort during a period of 10 days, personal service could not be had, service may be made by mailing, by registered or certified mail, copies of the notice addressed to the judge or judicial candidate at his last known residence and, if a judge, at his chambers, and the date of mailing shall be entered in the docket.

(b) ANSWER

Within 15 days after service of the notice of formal proceedings, the judge or judicial candidate may file with the Commission an original answer, which shall be verified, and twelve legible copies thereof.

(c) SETTING DATE FOR HEARING AND REQUEST FOR APPOINTMENT OF A SPECIAL MASTER

(1) Upon the filing of an answer or upon expiration of the time for its filing, the Commission shall set a time and place for hearing before itself or before a special master and shall give notice of such hearing by mail to the judge or judicial candidate at least 20 days prior to the date set.

(2) If the Commission directs that the hearing be before a special master, the Commission shall, when it sets a time and place for the hearing, transmit a written request to the Supreme Court to appoint a special master for such hearing, and the Supreme Court shall, within 10 days from receipt of such request, appoint an active or retired District Judge, a Judge of a Court of Civil Appeals, either active or retired, or a retired Justice of the Court of Criminal Appeals or Supreme Court to hear and take evidence in such matters.

(d) HEARING

(1) At the time and place set for hearing, the Commission, or the special master when the hearing is before a special master, shall proceed with the hearing as nearly as may be according to the rules of procedure governing the trial of civil causes in this State, subject to the provisions of Rule 5, whether or not the judge or judicial candidate has filed an answer or appears at the hearing. The examiner or other authorized officer shall present the case in support of the charges in the notice of formal proceedings.

(2) The failure of the judge or judicial candidate to answer or to appear at the hearing shall not, standing alone, be taken as evidence of the truth of the facts alleged to constitute grounds for removal or retirement. The failure of the judge or judicial candidate to testify in his own behalf or his failure to submit to a medical examination requested by the Commission or the master may be considered, unless it appears that such failure was due to circumstances unrelated to the facts in issue at the hearing.

(3) The proceedings at the hearing shall be reported by a phonographic reporter or by some qualified person appointed by the Commission and taking the oath of an official court reporter.

(4) When the hearing is before the Commission, not less than seven members shall be present while the hearing is in active progress. The Chairperson, when present, the Vice-Chairperson in the absence of the Chairperson, or the member designated by the Chairperson in the absence of both, shall preside. Procedural and other interlocutory rulings shall be made by the person presiding and shall be taken as consented to by the other members unless one or more calls for a vote, in which latter event such rulings shall be made by a majority vote of those present.

(e) EVIDENCE

At a hearing before the Commission or a special master, legal evidence only shall be received as in the trial of civil cases, except upon consent evidenced by absence of objection, and oral evidence shall be taken only on oath or affirmation.

(f) AMENDMENTS TO NOTICE OR ANSWER

The special master, at any time prior to the conclusion of the hearing, or the Commission, at any time prior to its determination, may allow or require amendments to the notice of formal proceedings and may allow amendments to the answer. The notice may be amended to conform to proof or to set forth additional facts, whether occurring before or after the commencement of the hearing. In case such an amendment is made, the judge or judicial candidate shall be given reasonable time both to answer the amendment and to prepare and present his defense against the matters charged thereby.

(g) PROCEDURAL RIGHTS OF JUDGES AND JUDICIAL CANDIDATES

(1) In the proceedings for his removal or retirement a judge shall have the right to be confronted by his accusers, the right and reasonable opportunity to defend against the charges by the introduction of evidence, to be represented by counsel, and to examine and cross-examine

witnesses. He shall also have the right to the issuance of subpoenas for attendance of witnesses to testify or produce books, papers and other evidentiary matter.

(2) When a transcript of the testimony has been prepared at the expense of the Commission, a copy thereof shall, upon request, be available for use by the judge or judicial candidate and his counsel in connection with the proceedings, or the judge or judicial candidate may arrange to procure a copy at his expense. The judge or judicial candidate shall have the right, without any order or approval, to have all or any portion of the testimony in the proceedings transcribed at his expense.

(3) If the judge or judicial candidate is adjudged insane or incompetent, or if it appears to the Commission at any time during the proceedings that he is not competent to act for himself, the Commission shall appoint a guardian ad litem unless the judge or judicial candidate has a guardian who will represent him. In the appointment of a guardian ad litem, preference shall be given, so far as practicable, to members of the judge's or judicial candidate's immediate family. The guardian or guardian ad litem may claim and exercise any right and privilege and make any defense for the judge or judicial candidate with the same force and effect as if claimed, exercised, or made by the judge or judicial candidate, if competent.

(h) REPORT OF SPECIAL MASTER

(1) After the conclusion of the hearing before a special master, he shall promptly prepare and transmit to the Commission a report which shall contain a brief statement of the proceedings had and his findings of fact based on a preponderance of the evidence with respect to the issues presented by the notice of formal proceedings and the answer thereto, or if there be no answer, his findings of fact with respect to the allegations in the notice of formal proceedings. The report shall be accompanied by an original and two copies of a transcript of the proceedings before the special master.

(2) Upon receiving the report of the special master, the Commission shall promptly send a copy to the judge or judicial candidate, and one copy of the transcript shall be retained for the judge's or judicial candidate's use.

(i) OBJECTIONS TO REPORT OF SPECIAL MASTER

Within 15 days after mailing of the copy of the special master's report to the judge or judicial candidate, the examiner or the judge or judicial candidate may file with the Commission an original and twelve legible copies of a statement of objections to the report of the special master, setting forth all objections to the report and all reasons in opposition to the findings as sufficient grounds for removal or retirement. A copy of any such statement filed by the examiner shall be sent to the judge or judicial candidate.

(j) APPEARANCE BEFORE COMMISSION

If no statement of objections to the report of the special master is filed within the time provided, the findings of the special master may be deemed as agreed to, and the Commission may adopt them without a hearing. If a statement of objections is filed, or if the Commission in the absence of such statement proposes to modify or reject the findings of the special master, the Commission shall give the judge or judicial candidate and the examiner an opportunity to be heard orally before the Commission, and written notice of the time and place of such hearing shall be sent to the judge or judicial candidate at least ten days prior thereto.

(k) EXTENSION OF TIME

The Chairperson of the Commission may extend for periods not to exceed 30 days in the aggregate the time for filing an answer, for the commencement of a hearing before the Commission, and for filing a statement of objections to the report of a special master, and a special master may similarly extend the time for the commencement of a hearing before him.

(l) HEARING ADDITIONAL EVIDENCE

(1) The Commission may order a hearing for the taking of additional evidence at any time while the matter is pending before it. The order shall set the time and place of hearing and shall indicate the matters on which the evidence is to be taken. A copy of such order shall be sent to the judge or judicial candidate at least ten days prior to the date of the hearing.

(2) The hearing of additional evidence may be before the Commission itself or before the special master, as the Commission shall direct; and if before a special master, the proceedings shall be in conformance with the provisions of Rule 10(d) to 10(g) inclusive.

(m) COMMISSION RECOMMENDATION

If, after hearing, upon considering the record and report of the special master, the Commission finds good cause therefore, it shall recommend to the Review Tribunal the removal, or retirement, as the case may be; or in the alternative, the Commission may dismiss the case or publicly order a censure, reprimand, warning, or admonition.

RULE 11. REQUEST BY COMMISSION FOR APPOINTMENT OF REVIEW TRIBUNAL

Upon making a determination to recommend the removal or retirement of a judge, the Commission shall promptly file a copy of a request for appointment of a Review Tribunal with the clerk of the Supreme Court, and shall immediately send the judge notice of such filing.

RULE 12. REVIEW OF FORMAL PROCEEDINGS

(a) A recommendation of the Commission for the removal or retirement, of a judge shall be determined by a Review Tribunal of seven Justices selected from the Courts of Appeals. Members of the Review Tribunal shall be selected by lot by the Chief Justice of the Supreme Court from all Appeals Justices sitting at the time of selection. Each Court of Appeals shall designate one of its members for inclusion in the list from which the selection is made, except that no Justice who is a member of the Commission shall serve on the Review Tribunal. The Justice whose name is drawn first shall be chairperson of the Review Tribunal. The clerk of the Supreme Court will serve as the Review Tribunal's staff, and will notify the Commission when selection of the Review Tribunal is complete.

(b) After receipt of notice that the Review Tribunal has been constituted, the Commission shall promptly file a copy of its recommendation certified by the Chairperson or Secretary of the Commission, together with the transcript and the findings and conclusions, with the clerk of the Supreme Court. The Commission shall immediately send the judge notice of such filing and a copy of the recommendation, findings and conclusions.

(c) A petition to reject the recommendation of the Commission for removal or retirement of a judge or justice may be filed with the clerk of the Supreme Court within thirty days after the filing with the clerk of the Supreme Court of a certified copy of the Commission's recommendation. The petition shall be verified, shall be based on the record, shall specify the grounds relied on and shall be accompanied by seven copies of petitioner's brief and proof of service of one copy of the petition and of the brief on the Chairperson of the Commission. Within twenty days after the filing of the petition and supporting brief, the Commission shall file seven copies of the Commission's brief, and shall serve a copy thereof on the judge.

(d) Failure to file a petition within the time provided may be deemed a consent to a determination on the merits based upon the record filed by the Commission.

(e) Rules 4 and 74, Texas Rules of Appellate Procedure, shall govern the form and contents of briefs except where express provision is made to the contrary or where the application of a particular rule would be clearly impracticable, inappropriate, or inconsistent.

(f) The Review Tribunal, may, in its discretion and for good cause shown, permit the introduction of additional evidence, and may direct that the same be introduced before the special master or the Commission and be filed as a part of the record in the Court.

(g) Oral argument on a petition of a judge to reject a recommendation of the Commission shall, upon receipt of the petition, be set on a date not less than thirty days nor more than forty days from the date of receipt thereof. The order and length of time of argument shall, if not otherwise ordered or permitted by the Review Tribunal, be governed by Rule 172, Texas Rules of Appellate Procedure.

(h) Within 90 days after the date on which the record is filed with the Review Tribunal, it shall order public censure, retirement, or removal, as it finds just and proper, or wholly reject the recommendation. The Review Tribunal, in an order for involuntary retirement for disability or an order for removal, may also prohibit such person from holding judicial office in the future.

(i) The opinion by the Review Tribunal shall be published if, in the judgment of a majority of the justices participating in the decision, it is one that (1) establishes a new rule of ethics or law, alters or modifies an existing rule, or applies an existing rule to a novel fact situation likely to recur in future cases; (2) involves a legal or ethical issue of continuing public interest; (3) criticizes existing legal or ethical principles; or (4) resolves an apparent conflict of authority. A concurring or dissenting opinion may be published if, in the judgment of its author, it meets one of the above indicated criteria, but in such event the majority opinion shall be published as well.

RULE 13. APPEAL TO SUPREME COURT

A judge may appeal a decision of the Review Tribunal to the Supreme Court under the substantial evidence rule.

RULE 14. MOTION FOR REHEARING

A motion for rehearing may not be filed as a matter of right. In entering its judgment the Supreme Court or Review Tribunal may direct that no motion for rehearing will be entertained, in which event the judgment will be final on the day and date of its entry. If the Supreme Court or Review Tribunal does not so direct and the judge wishes to file a motion for rehearing, he shall present the motion together with a motion for leave to file the same to the clerk of the Supreme Court or Review Tribunal within fifteen days of the date of the judgment, and the clerk of the Supreme Court shall transmit it to the Supreme Court or Review Tribunal for such action as the appropriate body deems proper.

RULE 15. SUSPENSION OF A JUDGE

(a) Any judge may be suspended from office with or without pay by the Commission immediately upon being indicted by a state or federal grand jury for a felony offense or charged with a misdemeanor involving official misconduct. However, the suspended judge has the right to a post-suspension hearing to demonstrate that continued service would not jeopardize the interests of parties involved in court proceedings over which the judge would preside nor impair public confidence in the judiciary. A written request for a post-suspension hearing must be filed with the Commission within 30 days from receipt of the Order of Suspension. Within 30 days from the receipt of a request, a hearing will be scheduled before one or more members or the executive director of the Commission as designated by the Chairperson of the Commission. The person or persons designated will report findings and make recommendations, and within 60 days from the close of the hearing, the Commission shall notify the judge whether the suspension will be continued, terminated, or modified.

(b) Upon the filing with the Commission of a sworn complaint charging a person holding such office with willful or persistent violation of rules promulgated by the Supreme Court of Texas, incompetence in performing the duties of office, willful violation of the Code of Judicial Conduct, or willful and persistent conduct that is clearly inconsistent with the proper performance of his duties or casts public discredit upon the judiciary or the administration of justice, the Commission, after giving the person notice and an opportunity to appear and be heard before the Commission (under Rule 6), may recommend to the Supreme Court the suspension of such person from office.

(c) When the Commission or the Supreme Court orders the suspension of a judge or justice, with or without pay, the appropriate city, county, and/or state officials shall be notified of such suspension by certified copy of such order.

RULE 16. RECORD OF COMMISSION PROCEEDINGS AND EDUCATION NONCOMPLIANCE

(a) The Commission shall keep a record of all informal appearances and formal proceedings concerning a judge or judicial candidate. In all proceedings resulting in a recommendation to the Review Tribunal for removal or retirement, the Commission shall prepare a transcript of the evidence and of all proceedings therein and shall make written findings of fact and conclusions of law with respect to the issues of fact and law in the proceeding.

(b) The Commission must publicly list on its website judges who have been suspended for noncompliance with judicial-education requirements set forth in governing statutes or rules.

RULE 17. CONFIDENTIALITY AND PRIVILEGE OF PROCEEDINGS

All papers filed with and proceedings before the Commission shall be confidential, and the filing of papers with, and the giving of testimony before the Commission shall be privileged; provided that:

(a) The formal hearing, and all papers, records, documents, and other evidence introduced during the formal hearing shall be public.

(b) If the Commission issues a public sanction, all papers, documents, evidence, and records considered by the Commission or forwarded to the Commission by its staff and related to the sanction shall be public.

(c) The judge or judicial candidate may elect to open the informal appearance hearing pursuant to Rule 6(b).

(d) Any hearings of the Special Court of Review shall be public and held at the location determined by the Special Court of Review. Any evidence introduced during a hearing, including papers, records, documents, and pleadings filed in the proceedings, is public.

RULE 18. *EX PARTE* CONTACTS BY MEMBERS OF THE COMMISSION

A Commissioner, except as authorized by law, shall not directly or indirectly initiate, permit, nor consider *ex parte* contacts with any judge or judicial candidate who is the subject of an investigation being conducted by the Commission or involved in a proceeding before the Commission.

Tab Z

TEXAS

STATE COMMISSION ON JUDICIAL CONDUCT

ANNUAL REPORT

2023

STATE COMMISSION ON JUDICIAL CONDUCT

COMMISSION MEMBERS

Gary Steel, Chair

Janis Holt, Vice-Chair

Ronald E. Bunch, Secretary

Valerie Ertz

Clifton Roberson

Kathy P. Ward

Wayne Money

Andrew M. “Andy” Kahan

Ken Wise

Carey F. Walker

Tano E. Tijerina

Clifford T. Harbin

Chace Craig

P.O. Box 12265 ★ Austin, Texas ★ 78711
Telephone (512) 463-5533 ★ Fax (512) 463-0511
Toll Free (877) 228-5750 ★ TDD (800) RELAY-TX
Website: scjc.texas.gov

COMMISSIONER INFORMATION

OFFICERS

CHAIR
Hon. Gary L. Steel
District Judge, Seguin
Appointed by Texas Supreme Court
Term Expires: 11/19/2023

VICE-CHAIR
Hon. Janis Holt
Public Member, Silsbee
Appointed by Governor
Term Expires: 11/19/2025

SECRETARY
Hon. Ronald E. Bunch
Attorney, Waxahachie
Appointed by State Bar of Texas
Term Expires: 11/19/23

MEMBERS

Hon. Valerie Ertz
Public Member, Dallas
Appointed by Governor
Term Expires: 11/19/2023

Hon. Clifton Roberson
Attorney, Tyler
Appointed by State Bar of Texas
Term Expires: 11/19/2025

Hon. Kathy P. Ward
Public Member, Plano
Appointed by Governor
Term Expires: 11/19/2027

Hon. Wayne Money
Justice of the Peace, Greenville
Appointed by Texas Supreme Court
Term Expires: 11/19/27

Hon. Andrew M. “Andy” Kahan
Public Member, Houston
Appointed by Governor
Term Expires: 11/19/2027

Hon. Ken Wise
Appeals Court Justice, Dallas
Appointed by Texas Supreme Court
Term Expires: 11/19/2025

Hon. Carey F. Walker
County Court at Law Judge, Fort Worth
Appointed by Texas Supreme Court
Term Expires: 11/19/2027

Hon. Tano E. Tijerina
County Judge, Laredo
Appointed by Texas Supreme Court
Term Expires: 11/19/2023

Hon. Clifford T. Harbin
Public Member, Montgomery
Appointed by Governor
Term Expires: 11/19/2023

Hon. Chace A. Craig
Municipal Judge, Abilene
Appointed by Texas Supreme Court
Term Expires: 11/19/2027

STATE COMMISSION
ON
JUDICIAL CONDUCT

COMMISSION STAFF

Jacqueline Habersham, Executive Director

Zindia Thomas, General Counsel

Ron Bennett, Chief Investigator

Lorin Hayes, Senior Commission Counsel

Erin Morgan, Commission Counsel

James Parsons, Commission Counsel

Katherine Mitchell, Senior Investigator

Cherie Thomas, Commission Investigator

Crystal Lopez, Commission Investigator

Elizabeth Trevino, Commission Investigator

Patricia Ortiz, Staff Services Officer

Connie Paredes, Administrative Assistant

Patricia Leal, Administrative Assistant

PHILOSOPHY

The members of the State Commission on Judicial Conduct and Commission staff take their obligations to the citizens and judges of Texas seriously. The political affiliation, gender, ethnicity, religious background, sexual orientation, socioeconomic status, geographical location, or the position of a complainant or a judge are not considered in the Commission's review of cases. The Commission's ability to fulfill its constitutional mandate requires that each Commissioner and staff member act with honesty, fairness, professionalism and diligence.

The agency reviews every allegation of misconduct made against a Texas judge. Each complaint alleging misconduct on its face is thoroughly investigated and analyzed by Commission staff before being presented to the Commissioners. This process helps preserve the public's confidence in the integrity of the judicial process. Judges are held to the highest standards of ethical conduct, both on and off the bench, and both Commission and its employees strive to conduct themselves in a similar manner.

OVERVIEW OF THE COMMISSION

Authority of the Commission

Created in 1965 by an amendment to Article V of the Texas Constitution, the State Commission on Judicial Conduct is the independent judicial branch agency responsible for investigating and addressing allegations of judicial misconduct or permanent disability.

The Commission's jurisdiction includes all sitting Texas judges, including municipal judges, justices of the peace, criminal magistrates, county judges, county court at law judges, statutory probate judges, district judges, appellate judges, masters, associate judges, referees, retired and former judges who sit by assignment, and judges *pro tempore*. The Commission has no jurisdiction over federal judges and magistrates, administrative hearing officers for state agencies or the State Office of Administrative Hearings, or private mediators or arbitrators. A judicial candidate, who is not already a sitting judge, is also required to comply with the Texas Code of Judicial Conduct. Effective September 1, 2022, the Texas Constitution was amended and provides that the Commission may, in its discretion, investigate and sanction a judicial candidate for an alleged violation of the canons.

Members of the Commission

There are thirteen members of the Commission, each of whom serves a staggered six-year term, as follows:

- Six judges, one from each of the following courts: appellate, district, county court at law, constitutional county, justice of the peace and municipal, appointed by the Supreme Court of Texas;
- Five citizen members who are neither attorneys nor judges, appointed by the Governor; and
- Two attorneys who are not judges, appointed by the State Bar of Texas.

By law, the appellate, district, constitutional and statutory county judges and the two attorney members who serve on the Commission must be appointed from different appellate districts in Texas. Meanwhile, the justice of the peace, municipal court judge and public members are at-large appointments. The Texas Senate confirms all appointees. Commissioners meet six times each year and receive no pay for their service.

Laws Governing the Commission

The Commission is governed by Article V, Section 1-a, of the Texas Constitution, Chapter 33 of the Texas Government Code, the Texas Procedural Rules for the Removal or Retirement of Judges, and the Texas Code of Judicial Conduct. As a part of the judicial branch with its own constitutional and statutory provisions regarding confidentiality of papers, records and proceedings, the Commission is not governed by the Texas Public Information Act, the Texas Open Meetings Act, or the Texas Administrative Procedures Act.

Defining Judicial Misconduct

Article V, Section 1-a(6)A of the Texas Constitution defines judicial misconduct as the “willful or persistent violation of rules promulgated by the Supreme Court of Texas, incompetence in performing the duties of the office, willful violation of the Code of Judicial Conduct, or willful or persistent conduct that is clearly inconsistent with the proper performance of [the judge’s] duties or casts public discredit upon the judiciary or administration of justice.”

Accordingly, a judge’s violation of the Texas Constitution, the Texas Penal Code, the Texas Code of Judicial Conduct, or rules promulgated by the Supreme Court of Texas may constitute judicial misconduct. Specific examples of judicial misconduct include:

- failure to cooperate with the Commission’s investigation
- inappropriate or demeaning courtroom conduct, including yelling, use of profanity, demonstrated gender bias or the use of racial slurs
- improper *ex parte* communications with only one side in a case
- a public comment regarding a pending case
- presiding over a case in which the judge has an interest in the outcome, or in which any of the parties, attorneys or appointees are related to the judge within a prohibited degree of kinship
- out of court activities, including criminal conduct, engaging in improper financial or business dealings, improper fundraising activities, sexual harassment or official oppression

Sources of Complaints and Allegations

The Commission considers allegations from any source, including an individual, a news article, or information obtained during an investigation. There is no requirement that a person who files a complaint be the target or victim of the alleged misconduct, nor does the Commission require a complainant to have firsthand knowledge of the alleged misconduct. Complaints may be made anonymously, or a complainant may request confidentiality; however, anonymous complaints and requests for confidentiality may restrict the Commission’s ability to fully investigate the allegations. Furthermore, while the Commission strives to maintain confidentiality to those complainants who request it, the Commission may, in its discretion, reveal the identity of a confidential complainant when doing so serves the Commission’s interest in protecting the public by addressing misconduct.

Commission Limitations

The Commission does not have the power or authority of a court in this state, cannot change the decision or ruling of any court, nor can the Commission intervene in any pending case or proceeding. The Commission is also unable to remove a judge from a case. If the Commission determines that a judge has committed misconduct in an ongoing case, the Commission may only issue a sanction against the judge, or institute proceedings that would authorize the eventual removal of the judge from the bench. Nonetheless, it is the strong preference of the Commission not to make any finding that would impact or alter the outcome of an ongoing case. Neither the Commission nor its staff can provide legal assistance or advice to a complainant, nor can it award damages or provide monetary or other relief to anyone.

Commission Investigations and Actions

Complaints are reviewed, analyzed and investigated by Commission staff. An investigation may include a review of court records and witness interviews. The Commission also endeavors to obtain a respondent judge’s perspective before contemplating issuing any discipline against the judge. Once all the information is obtained through the investigation, the materials are presented to the Commission for deliberation. Typically, the Commission will either dismiss or sanction a judge at that point. Occasionally, as the facts and law warrant, the Commission may seek to suspend a judge, accept a voluntary resignation agreement from a judge in lieu of disciplinary action, or institute formal proceedings, as appropriate.

Commission Organization and Staff

In fiscal year 2023, the Commission had fourteen authorized staff positions (Full Time Equivalents, or “FTEs”). For the year, Commission’s staff included the Executive Director, the General Counsel, four staff attorneys, Chief Investigator, four investigators, a staff services officer, and two administrative assistants. All Commission staff members are full time State employees.

The Commission’s legal staff, which consists of attorneys and investigators, is responsible for the evaluation and investigation of complaints. The investigators and legal assistants handle in-house and field investigations, screen all new cases and are also responsible for preparing legal documents and assisting the attorneys in the prosecution of disciplinary proceedings. The attorneys are responsible for investigating allegations of judicial misconduct or incapacity, presenting cases to the Commission, prosecuting disciplinary cases before Special Courts of Review, Special Masters, and Review Tribunals, responding to ethics calls, and speaking about judicial ethics at judicial educational and training seminars.

The Commission staff attorneys serve as Examiners, or trial counsel, during formal proceedings and on appeals from Commission actions. The Examiner is responsible for all aspects of preparing and presenting a case before the Commission, Special Master, Special Court of Review or Review Tribunal. The Commission may also employ Special Counsel, chosen from distinguished members of the bar, to assist staff in preparing and presenting these cases. Attorneys from the Office of the Attorney General have also represented the Commission as Special Counsel in formal proceedings and Special Courts of Review.

The Executive Director heads the agency and reports directly to the Commission. The Executive Director is also the primary liaison between the Commission and the judiciary, legislators, other government officials, the public and the media.

Outreach and Education

In fiscal year 2023, the Executive Director and staff attorneys participated in over 20 presentations at judicial training courses, bar conferences, outreach programs, and court staff workshops, describing the Commission and its operations and discussing various forms of judicial misconduct.

Ethics Calls

In fiscal year 2023, the Executive Director and staff attorneys responded to more than 300 inquiries from judges, judicial candidates, attorneys, legislators, the media and citizens regarding judicial ethics. Callers are informed that Commission staff cannot issue an opinion on behalf of the Commission, and that the Commission is not bound by any comments made during the conversation. As appropriate, a caller’s question may be researched before the call is returned so that the specific canon, statute, rule or ethics opinion can be identified. When appropriate, staff will send the caller a Complaint Form (in English or Spanish) and other relevant material. In some instances, staff may refer callers to other resources or agencies better able to address their concerns.

Commission Website

The Commission's website also provides downloadable complaint forms in English and Spanish. The website offers: answers to frequently-asked questions regarding the Commission's composition, structure and jurisdiction; information about the judicial complaint process; a description of the range of decisions the Commission can make; explanations of the procedures for a judge or a complainant to appeal a decision by the Commission. Further, the website provides statistical information about the Commission and updated sanctions, resignations, suspensions, and Opinions issued by Special Courts of Review and Review Tribunals.

The Commission's governing provisions (the Texas Code of Judicial Conduct; Article V, Section 1-a of the Texas Constitution; Chapter 33 of the Texas Government Code; and the Texas Procedural Rules for the State Commission on Judicial Conduct) are all linked on the website as well.

Public Information

The availability of information and records maintained by the Commission is governed by Rule 12 of the Texas Rules of Judicial Administration, the Texas Constitution and the Texas Government Code. Commission records are not subject to public disclosure pursuant to the Public Information Act (formerly the Open Records Act) or the Freedom of Information Act.

Generally, Commission records are confidential, with the following exceptions:

- <u>Constitution</u>: Article V, Section 1-a(10) of the Texas Constitution provides that "All papers filed with and proceedings before the Commission or a Master shall be confidential, unless otherwise provided by law…"
- <u>Government Code</u>:
    - When the Commission issues a public sanction against a judge, Section 33.032 of the Texas Government Code provides that "the record of the informal appearance and the documents presented to the commission during the informal appearance that are not protected by attorney-client or work product privilege shall be public."
    - This Section also provides that suspension orders and voluntary agreements to resign in lieu of disciplinary proceedings are publicly available.
    - Section 33.032 also authorizes the release to the public of papers filed in a formal proceeding upon the filing of formal charges.
- <u>Judicial Administration:</u> Rule 12 of the Texas Rules of Judicial Administration provides for public access to certain records made or maintained by a judicial agency in its regular course of business, *but not pertaining to its adjudicative function*. Commission records relating to complaints, investigations, and its proceedings are not judicial records and are not subject to public disclosure pursuant to Rule 12.

When the Commission takes action on a complaint, whether dismissing it, issuing a private or public sanction, accepting a voluntary agreement to resign in lieu of disciplinary action, or instituting formal proceedings, the complainant is notified in writing. However, the Texas Government Code requires that the Commission omit the judge's name from the notice to the complainant unless a public sanction has been issued.

Additionally, the Constitution provides that in instances where issues concerning a judge or the Commission have been made public by sources other than the Commission, the Commission may make a public statement. In such a situation, the Commission determines whether the best interests of a judge or the public will be served by issuing the statement. No public statements were issued in fiscal year 2023.

THE COMPLAINT PROCESS

Introduction

Each complaint stating an allegation of judicial misconduct is thoroughly reviewed, investigated and analyzed by the Commission staff. Complaints must be filed with the Commission in writing. Complaints sent by fax or through email are generally not accepted.

Complaint forms are available in English and Spanish from the following sources:

- Download from the Commission's website at http://www.scjc.texas.gov/complaints/
- Telephone requests to the Commission at (512) 463-5533 or toll free at (877) 228-5750

The Commission may also initiate a complaint based upon a media report, court documents, the internet or other sources. A complainant may request that the Commission keep his or her identity confidential. Additionally, the Commission accepts anonymous complaints.

After a complaint is filed, the Commission sends an acknowledgment letter to the complainant and staff begins its investigation and analysis of the allegations. Complainants may be asked to provide additional information or documents. As appropriate, staff conducts legal research and contacts witnesses. If the evidence obtained during the investigation calls for a response from the judge, an attorney will contact the judge to obtain a response to the allegations before presenting the matter to the Commission for consideration. When deemed appropriate by staff, an attorney or investigator may travel to the judge's county for further investigation and interviews.

When the investigation is completed, the case is presented to the Commission for its consideration. In some cases, the Commission may invite a judge, complainant, or other witnesses to appear and discuss the allegations. Based on the specific constitutional provisions, statutes and canons under which the Commission operates, it considers and votes on every complaint investigated by staff.

If the Commission chooses to issue a public sanction, an order describing the Commission's findings is prepared and distributed to the respondent judge, with a copy provided to the complainant. The order is then publicly disseminated to ensure public awareness. If the Commission votes to issue a private sanction, the appropriate order is prepared and tendered to the respondent judge, and the complainant is notified by letter of the Commission's action. Because the Commission is controlled by constitutional and statutory provisions that prohibit the release of information regarding investigation and resolution of a case, the only details released to the public are a summary of the operative facts of the matter posted on the Commission's website. However, in cases where a judge has voluntarily agreed to resign in lieu of disciplinary action, that agreement becomes public upon the Commission's acceptance of it, and the complainant is so notified.

Likewise, whenever the Commission suspends a judge after he or she has been indicted for a criminal offense, or charged with a misdemeanor involving official misconduct, the Commission releases the order of suspension and all records related to any post-suspension proceedings to the public.

Commission Decisions

Commission members review, deliberate and vote on each investigated complaint. This may result in a dismissal, a public or private order of additional education either alone or in combination with a public or private sanction, a public or private admonition, warning or reprimand, the acceptance of a voluntary agreement to resign from judicial office in lieu of disciplinary action, or formal proceedings for removal or retirement of the judge from the bench. If the judge appeals a decision of the Commission, the Texas Supreme Court randomly appoints three appellate judges to serve as a Special Court of Review. That Court's decision-making authority includes dismissal, affirmation of the Commission decision, imposition of a greater or lesser sanction, or the initiation of formal proceedings. The decision of the Special Court of Review is final and may not be appealed.

The Commission's decisions and actions in responding to allegations or complaints of judicial misconduct fall into one of the following categories:

1. Administrative Dismissal Report ("ADR")

A case is dismissed administratively when a complainant's writing fails to state an allegation which, if true, would constitute one or more of the following: (a) a willful or persistent violation of rules promulgated by the Supreme Court of Texas, (b) incompetence in performing the duties of the office, (c) willful violation of the Texas Code of Judicial Conduct, or (d) willful or persistent conduct that is clearly inconsistent with the proper performance of his duties or casts public discredit upon the judiciary or administration of justice. Generally, the fact that a judge made a legal error while ruling on a motion, an objection, the admission or exclusion of evidence, or in the ultimate outcome of the case, does not constitute judicial misconduct unless there is evidence of bad faith, persistent legal error, or the legal error was egregious. Only an appellate court has the power to review and change a judge's decision in any case. In addition, gratuitous claims of misconduct unsupported by any facts or evidence will often be administratively dismissed. These cases are dismissed following an initial review without an investigation. In letters of dismissal sent to these complainants, the Commission provides an explanation for the decision and provides Complainants the opportunity to have the Commission reconsider the decision to dismiss the case before investigation. Staff may grant a complainant's ADR reconsideration request, but only the Commission has the authority to deny an ADR reconsideration request.

2. Dismissal

The Commission may dismiss a case after conducting a preliminary or full investigation of the allegations. Reasons for these dismissals include insufficient or no evidence of misconduct,[1] the judge demonstrated that he or she took appropriate actions to correct the conduct at issue, or the conduct, though problematic, did not rise to the level of sanctionable misconduct. In letters of dismissal sent to these complainants, the Commission provides an explanation for the dismissal, and describes the steps the complainant may take for the Commission to reconsider its decision. The Commission may also include cautionary advice to judges whose complaints have been dismissed after the judge has taken appropriate corrective action or in those cases where disciplinary action was deemed unwarranted given the facts and circumstances surrounding the alleged infraction.

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[1] In contrast to cases dismissed administratively following an initial review, cases dismissed following a preliminary investigation in which it was determined that there was no evidence of judicial misconduct are classified as "frivolous" pursuant to Section 33.022 of the Texas Government Code.

3. Order of Additional Education

Legal and procedural issues are often complex, so it is not surprising that some judges take judicial action beyond their authority or contrary to procedural rules. In these situations, the Commission may conclude that the judge has demonstrated a deficiency in a particular area of the law, warranting an order of additional education. The Commission then coordinates the assignment of a mentor judge for one-on-one instruction with the judge, to be completed within a specified time on particular subjects. The mentor judge then reports to the Commission on the respondent judge's progress. The Commission may also order the judge to obtain education on other issues, such as anger management, gender or racial sensitivity, or sexual harassment. The Commission may issue an order of additional education alone or as part of a private or public sanction.

4. Private or Public Sanction

The Commission issues disciplinary sanctions when a preponderance of evidence supports a finding of judicial misconduct. The most severe disciplinary action available to the Commission is a *public censure*, which may be issued only after formal proceedings have been initiated by the Commission. If, after a public fact-finding trial, the Commission determines that the underlying allegations of the complaint are true but do not support a recommendation for removal from office, a *censure* may be issued as a public denunciation of the judge's conduct. Alternatively, the Commission may also issue a public reprimand, warning, or admonition following a formal proceeding.

The next most severe sanction is a *public reprimand*. A *reprimand* is the most severe sanction available to the Commission at the informal stage of disciplinary proceedings. A less severe sanction is a *public warning*, followed by a *public admonition*. A *warning* puts the judge on notice that the actions identified in the sanction are improper. An *admonition* is the lowest level of sanction.

A judge may appeal any sanction or public censure to a Special Court of Review. The process for appealing a public censure, reprimand, warning or admonition issued by the Commission after formal proceedings is different than that of a *de novo* review of a sanction issued after informal proceedings.

If a *public sanction* or *censure* is issued, all information considered by the Commission, including the judge's name, is made public. Public sanctions are issued not only to identify the specific conduct, but to educate judges that such conduct is inappropriate. This also ensures that the public is made aware of actions that violate the Code of Judicial Conduct. When the Commission elects to issue a *private sanction*, the judge's name and all information considered by the Commission remain confidential.

5. Suspension

The Commission has the power to suspend a judge from office, with or without pay, after the judge has been either indicted by a grand jury for a felony, or charged with a misdemeanor involving official misconduct. In these cases, the suspended judge has the right to a post-suspension hearing before one or more of the Commission members or the Executive Director, as designated by the Commission Chair.

In cases other than formal criminal charges, the Commission, upon the filing of a sworn complaint and after giving the judge notice and an opportunity to appear before the Commission, may recommend to the Supreme Court of Texas that a judge be suspended from office, with or without pay, for persistent violation of rules promulgated by the Supreme Court, incompetence in performing the duties of office, willful violation of the Code of Judicial Conduct, or willful and persistent conduct that is clearly inconsistent with the proper performance of his or her duties, or that casts public discredit on the judiciary or the administration of justice.

6. Voluntary Agreement to Resign in Lieu of Discipline

In some cases, a judge subject to a Commission investigation may decide to resign in lieu of disciplinary action. In that event, the judge may tender to the Commission a voluntary agreement to resign from judicial office. Upon the Commission's acceptance, the agreement is made public and the judge vacates the bench. The agreement and any agreed statement of facts relating to it are admissible in subsequent proceedings before the Commission. While the agreement, including any documents referenced in the agreement, is public, any other records relating to the underlying case remain confidential and are only released to the public if the judge violates a term of the agreement.

7. Formal Proceedings

In certain circumstances, the Commission may decide that a complaint against a judge is so egregious that it should be handled and resolved through a formal proceeding. The Commission itself may conduct such a fact-finding hearing, or it may request the Supreme Court of Texas to appoint a Special Master (who must be a sitting or retired district or appellate judge) to hear the matter. Such proceedings are governed by the Texas Rules of Civil Procedure and the Texas Rules of Evidence to the extent practicable.

Although there is no right to a trial by jury in a formal proceeding, the judge is afforded certain other rights in a formal proceeding under the Texas Procedural Rules for the State Commission on Judicial Conduct, including the following:

- to be confronted by the judge's accusers
- to introduce evidence
- to be represented by counsel
- to examine and cross-examine witnesses
- to subpoena witnesses
- to obtain a copy of the reporter's record of testimony

If the formal proceeding has been conducted before a Special Master, he or she reports the findings of fact to the Commission. If either party files objections to the Master's Report, the Commission will hold a public hearing to consider the report of the Special Master and any objections. The Commission may adopt the Special Master's findings in whole or in part, modify the findings, totally reject them and enter its own findings, or order a hearing for the taking of additional evidence.

After adopting findings of fact, the Commission issues its conclusions of law. The Commission may dismiss the case, issue a public censure, reprimand, warning or admonition, or recommend removal or involuntary retirement to a seven-member Review Tribunal appointed by the Supreme Court of Texas. The Commission itself cannot permanently remove a judge; only the Review Tribunal can order a judge removed from the bench. The Review Tribunal may also enter an order prohibiting the judge from ever holding a judicial office again.

Although the Commission's recommendation for removal cannot be appealed, the judge may appeal the decision of the Review Tribunal to the Texas Supreme Court. A judge may also appeal the Commission's decision to issue a public censure or sanction to a Special Court of Review.[2]

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[2] In 2009, Section 33.034 of the Texas Government Code was amended to provide judges the right to appeal a public censure issued by the Commission following a formal proceeding. In 2013, Section 33.034 was amended further to provide the right to

Appellate Review of Commission Action

A judge may appeal the Commission's issuance of any public or private sanction, order of additional education, or public censure within thirty days of the date the Commission issues the sanction by filing a written notice with the Chief Justice of the Supreme Court of Texas and requesting the appointment of three appellate justices to act as a Special Court of Review.

Within fifteen days after the Special Court of Review is appointed, the Commission, through its Examiner, must file with the Clerk of the Texas Supreme Court a "charging document," which includes a copy of the sanction issued, as well as any additional charges to be considered in the *de novo* proceeding.[3] These records become public upon filing with the Clerk, who is responsible for furnishing a copy to the petitioning judge and to each justice on the Special Court of Review.

In an appeal of a sanction issued following the informal proceeding stage, a trial *de novo* is scheduled within thirty days after the charging document is filed. The Special Court of Review considers the case from the beginning, as though it were standing in the place of the Commission (though the Special Court of Review is made aware of the Commission's decision). The Texas Rules of Civil Procedure apply, insofar as practicable, except that the judge is not entitled to a jury trial. All documents filed and evidence received in the review process are public.

The Special Court of Review may dismiss or affirm the Commission's decision, impose a greater or lesser sanction, or order the Commission to file formal proceedings against the subject judge for removal or involuntary retirement. The decision of the Special Court of Review is final and cannot be appealed.

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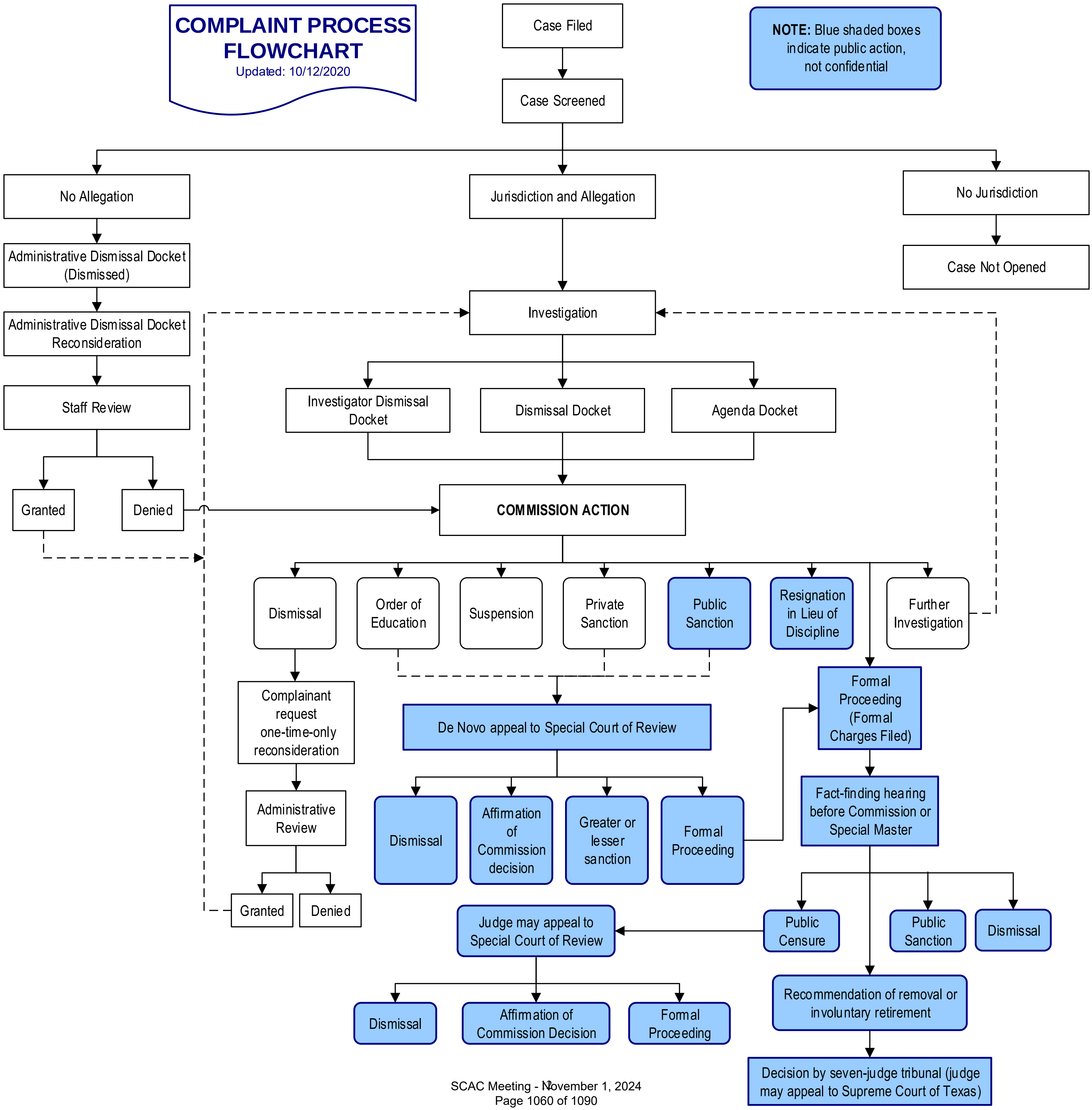
appeal a public reprimand, warning, or admonition issued after a formal proceeding. The Texas Supreme Court has been charged with the responsibility of drafting the procedural rules that will govern this process.

[3] Sanctions issued in the informal proceeding stage may be reviewed in a trial *de novo,* in the same way that a case tried in a justice court may be appealed to a county court. By contrast, the appeal of a sanction or censure issued following a formal proceeding is a "review of the record of the proceedings that resulted in the sanction or censure and is based on the law and facts that were presented in the proceedings and any additional evidence that the Special Court of Review in its discretion may, for good cause shown, permit." *See* Section 33.034(e)(1), Texas Government Code.

COMPLAINT PROCESS FLOWCHART

Updated: 10/12/2020

NOTE: Blue shaded boxes indicate public action, not confidential



STATISTICAL ANALYSIS

An outline of the statistical activity for the Commission through the end of fiscal year 2023 is shown in **Table 1** immediately following this section. In compliance with Section 33.005 of the Texas Government Code, the chart on **Table 2** provides a breakdown of the dispositions of the 1,173 cases closed during fiscal year 2023, including the number of cases dismissed following preliminary investigation with a determination that the allegation was frivolous or unfounded, or because the facts alleged did not constitute judicial misconduct or the evidence did not support the allegation of judicial misconduct. **Table 3** shows, in order of prevalence, the types of allegations or canon violations that resulted in disciplinary action during fiscal year 2023. Graphic representations of the data are also presented in **Figures 1** through **7** to further illustrate the activities of the Commission.

According to Office of Court Administration records, approximately 3,880 judges were under the jurisdiction of the Commission in fiscal year 2023, (less than a 4% increase from fiscal year 2022 – 3,775.)

Figure 1 illustrates the makeup of the Texas judiciary by the number of judges in each category. **Figure 2** shows the number and percentage of cases filed with the Commission by judge type. **Figure 3** shows the number of complaints resulting in disciplinary action by the Commission against each judge type. **Figure 4** shows the number of cases disposed by type of complainant in fiscal year 2023.

In fiscal year 2023, the Commission acted in 62 cases involving Texas judges. The Commission disposed of 45 cases through public sanction, private sanction, orders of additional education or a combination of a sanction with an order of additional education. 4 cases were resolved by a voluntary agreement to resign from judicial office. The Commission issued 4 orders of suspension in fiscal year 2023. Additionally, 9 cases were resolved by Special Court of Review orders.

Figures 5a and 5b show the total number of cases filed and disposed by the Commission between fiscal years 2019 and 2023. In fiscal year 2023, the Commission opened 925 cases – a 47% decrease over the number of filings in fiscal year 2022. The Commission disposed of 1173 cases in fiscal year 2023, representing a 52% decrease in dispositions over fiscal year 2022. With 925 complaints received and 1173 dispositions, the Commission's disposition rate for fiscal year 2023 was 126.81%.

A comparison of public discipline, private discipline and interim actions taken by the Commission in fiscal years 2019 through 2023 is shown in **Figures 6a** and **6b**.

Of the 1128 cases closed in fiscal year 2023, 46 were dismissed with language advising the judge about technical or *de minimus* violations, or violations of aspirational canons, and cautioning the judge to avoid similar conduct in the future. Additionally, 2 cases were dismissed after the judge demonstrated that he or she took appropriate measures to correct conduct that resulted in an investigation. Approximately 40% of the cases closed in fiscal year 2023 alleged no judicial misconduct. The percentage (48%) of cases closed following a preliminary investigation increased in 2023 relative to 2022 by 17%. Additionally, the percentage (14%) of full investigations requiring a response from the judge increased (marginally) in fiscal year 2023 relative to 2022 by 1%. A comparison of initial, preliminary, and full investigations conducted by the Commission in fiscal years 2019 through 2023 is shown in **Figures 7a** and **7b**.

During fiscal year 2023, the Commission referred 1 complaint against 1 judge to law enforcement. At the end of fiscal year 2023, the Commission had 165 open cases which were pending for a year or more, in which no tentative sanction had been issued, (approximately the same as 2023), but a 40% decrease from 2022.

Finally, the Commission receives hundreds of items of correspondence (i.e., mail, email, submissions through its website) every year that do not pertain to the conduct of Texas judges. In fiscal year 2023, over people wrote to the Commission countless times (via mail or email) complaining of individuals or entities that were outside of the Commission’s jurisdiction, requesting legal advice/representation by the Commission or other assistance. Commission Staff was responsive to such correspondence, and whenever possible, provided those complainants additional written information and referred to other resources to help them resolve their concerns.

HB 4344 Reporting

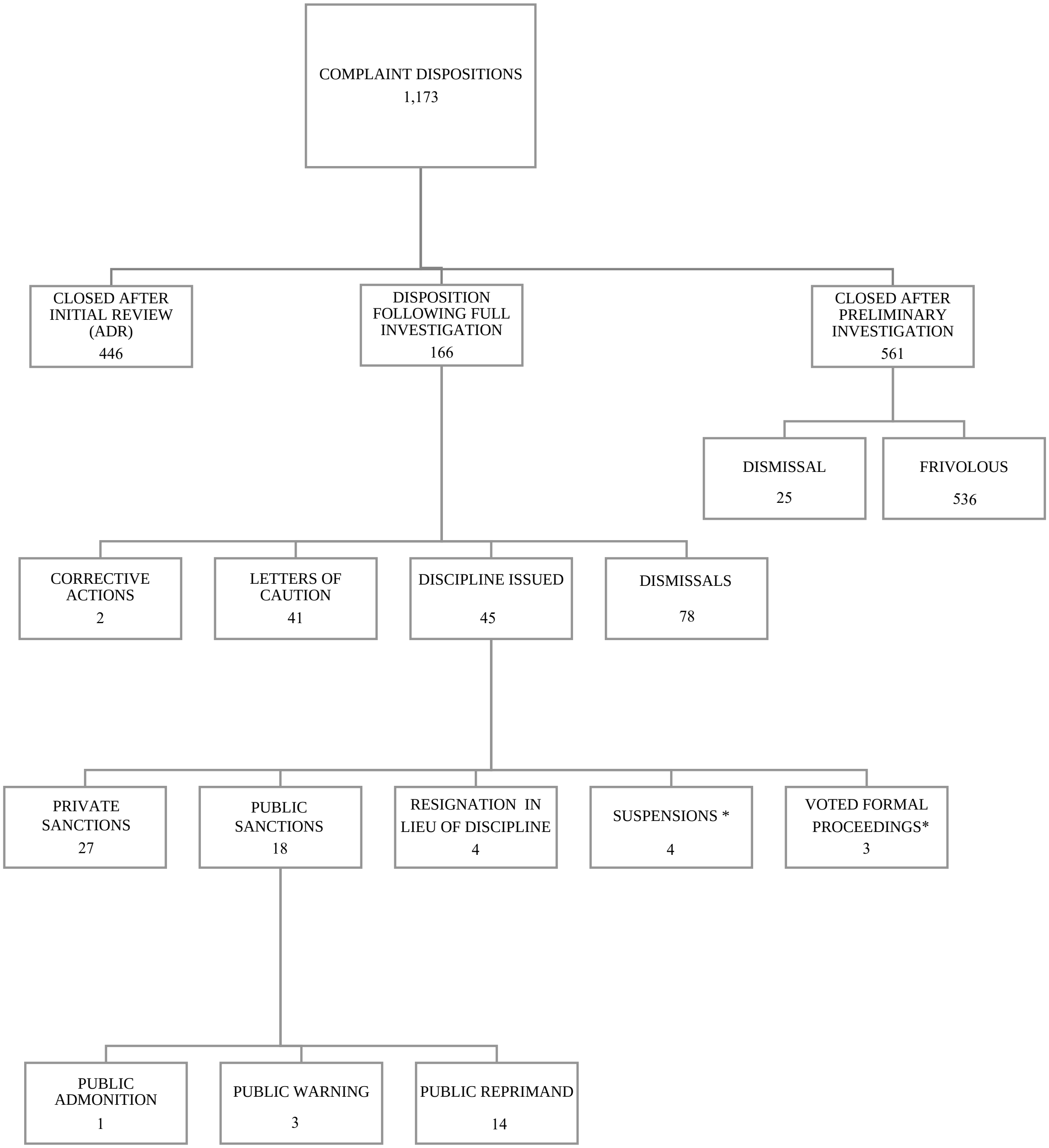
During the 87th Legislative Session, the Texas Legislature passed HB 4344 amending Chapter 33 of the Texas Government Code which imposed a 270-day statutory timeframe to resolve complaints filed with the Commission. Effective September 1, 2022, Section 33.041 of the Texas Government Code requires that the Commission to prepare and submit to the Texas Legislature a report of: (i) the total number of complaints the Commission failed to finalize not later than the 270th day following the date the complaint was filed with the Commission and (ii) the total number of complaints that the Commission declined to further investigate because of a law enforcement agency investigation. During Fiscal Year 2023, the Commission failed to finalize twenty-two (22) complaints within 270 days imposed by statute. Additionally, the Commission declined to further investigate one (1) complaint because of a law enforcement agency investigation. (Note: Most often, the Commission will investigate a complaint that was investigated by law enforcement, if the result of law enforcement’s investigation did not result in a conviction disqualifying the judge from the bench.)

Table - Commission Activity Report

Item	FY 2020	FY 2021	FY 2022	FY 2023
Cases Pending (Beginning FY/Current)	806/1067	1067/1040	1099/575	575/326
Cases Filed	1518	1724	1764	925
Total Number of Cases Disposed	1240	1656	2229	1173
% of Cases Disposed/Filed	81.69%	96.06%	126.36%	126.81%
Average Age of Case Disposed (in months)	6.28	7.62	8.02	6.00
Disciplinary Action (total)[1]	64	94	122	62
Cases Disposed through:				
Criminal Conviction[2]	0	7	2	0
Review Tribunal Order	0	0	0	0
Special Court of Review Order	8	3	9	9
Voluntary Agreement to Resign in Lieu of Disciplinary Action	1	8	2	4
Public Sanction				
Censure	0	0	0	0
Reprimand	2	1	10	14
Reprimand and Order of Add'l Education	0	3	5	0
Warning	5	21	10	1
Warning and Order of Add'l Education	1	15	0	2
Admonition	8	10	12	1
Admonition and Order of Add'l Education	4	6	3	1
Order of Add'l Education	0	0	0	0
Private Sanction				
Reprimand	4	1	0	2
Reprimand and Order of Add'l Education	0	3	2	4
Warning	25	5	6	3
Warning and Order of Add'l Education	3	8	12	7
Admonition	2	5	7	4
Admonition and Order of Add'l Education	5	2	7	3
Order of Add'l Education	0	3	4	3
Interim Disciplinary Action (total)				
Order of Suspension [15(a)]	1	1	6	3
Recommendation of Suspension to Supreme Court [15(b)]	0	0	1	1
Cases in Formal Proceedings	3	1	24[3]	27[3]
Dismissals (ADRs)[4]	1180 (763)	1573 (1022)	2151 (1239)	1128 (446)
Requests for Reconsideration Received	19	37	68	67
Reconsideration Granted/Denied	01/18	1/36	2/66	1/66
Pending	0	0	0	0
Cases Appealed to Special Court of Review	4	8	13	13
Informal Hearings held	15	18	55	26
Public Statements Issued	0	0	0	0

[1] Disciplinary Action includes sanctions, special court of review orders, voluntary agreements to resign in lieu of disciplinary action, orders of suspension, and formal proceedings.
[2] Cases resolved through criminal convictions are dismissals.
[3] 22 of the 27 cases in formal proceedings concern one judge.
[4] Dismissals include regular dismissals, administrative dismissal reports (ADR), dismiss with letter of caution, dismiss as moot criminal (criminal conviction), dismiss as moot (deceased).

TABLE 2
2023 COMPLAINT DISPOSITIONS



**Not a final disposition.*

TABLE 3 – TYPES OF CONDUCT RESULTING IN DISCIPLINE IN FISCAL YEAR 2023

The types of conduct are listed in order of prevalence. The numbers indicate the number of cases each type of conduct resulted in discipline. *(Includes public and private discipline.)*

Willful or Persistent Conduct Cast Public Discredit upon the Judiciary [32]

Failed to Comply with Law [26]

Incompetence [23]

Extra-Judicial Activity Casts Doubt on Impartiality [12]

Using Prestige of Judicial Office/ Influential Relationship [12]

Right to be Heard [10]

Improper Demeanor [8]

General Bias/ Prejudice [5]

Improper Ex Parte Communications [5]

Failure to Obtain Judicial Education [4]

Failure to Cooperate with the Commission [3]

Bias/Prejudice Based on Protected Class [2]

Authorize Name to Endorse Candidate [1]

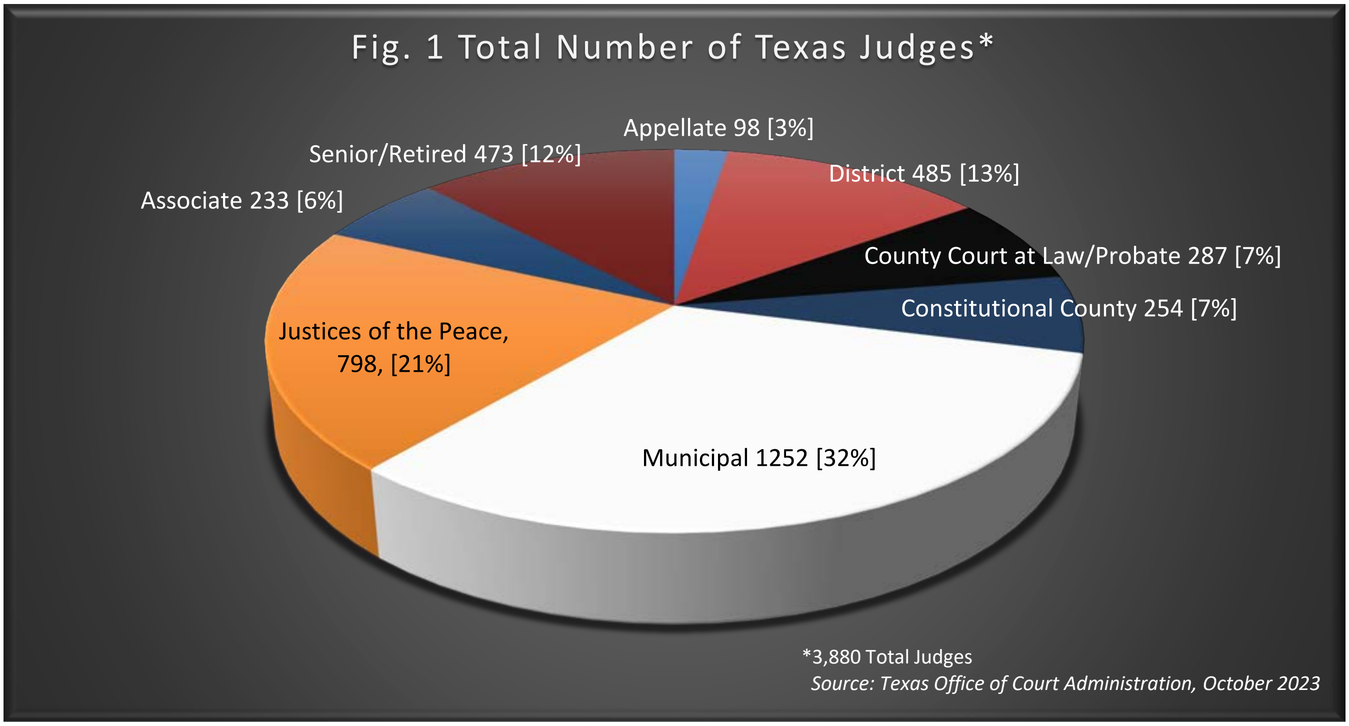


Fig. 1 Total Number of Texas Judges*

*3,880 Total Judges

Source: Texas Office of Court Administration, October 2023

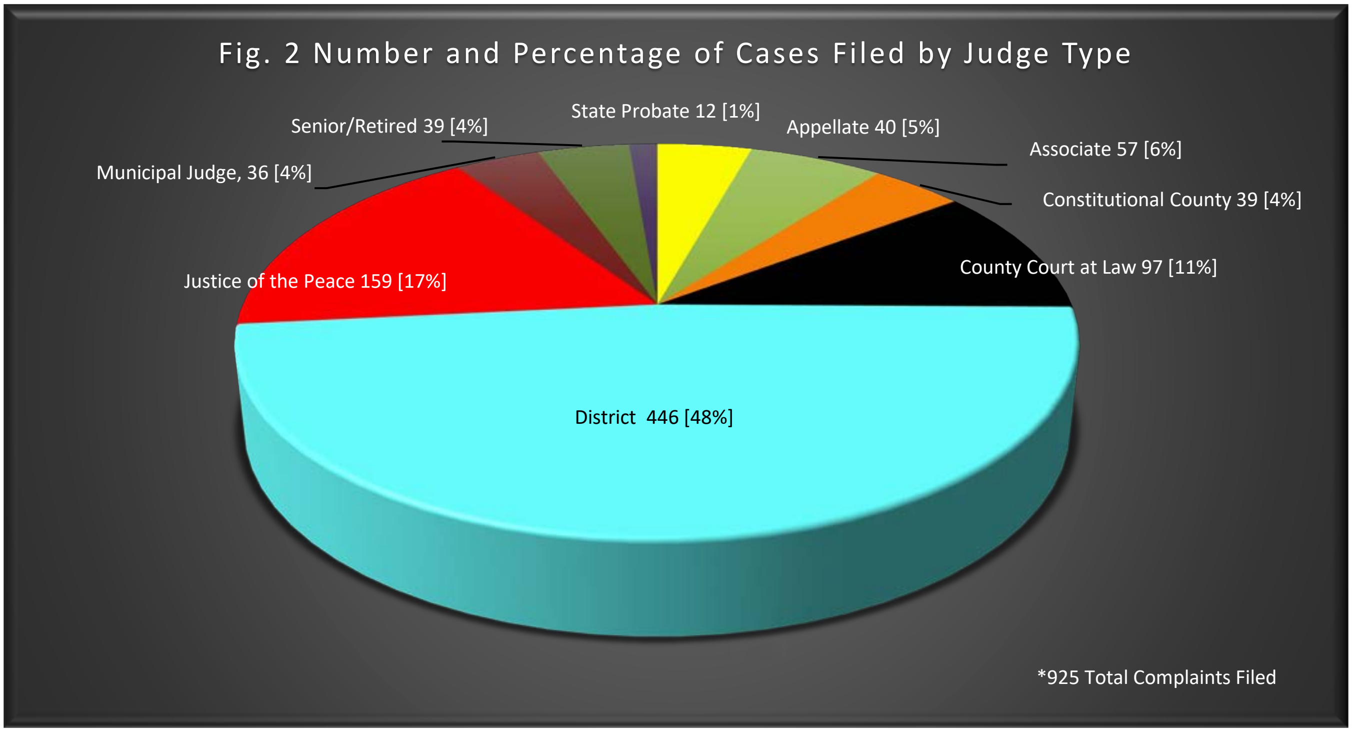
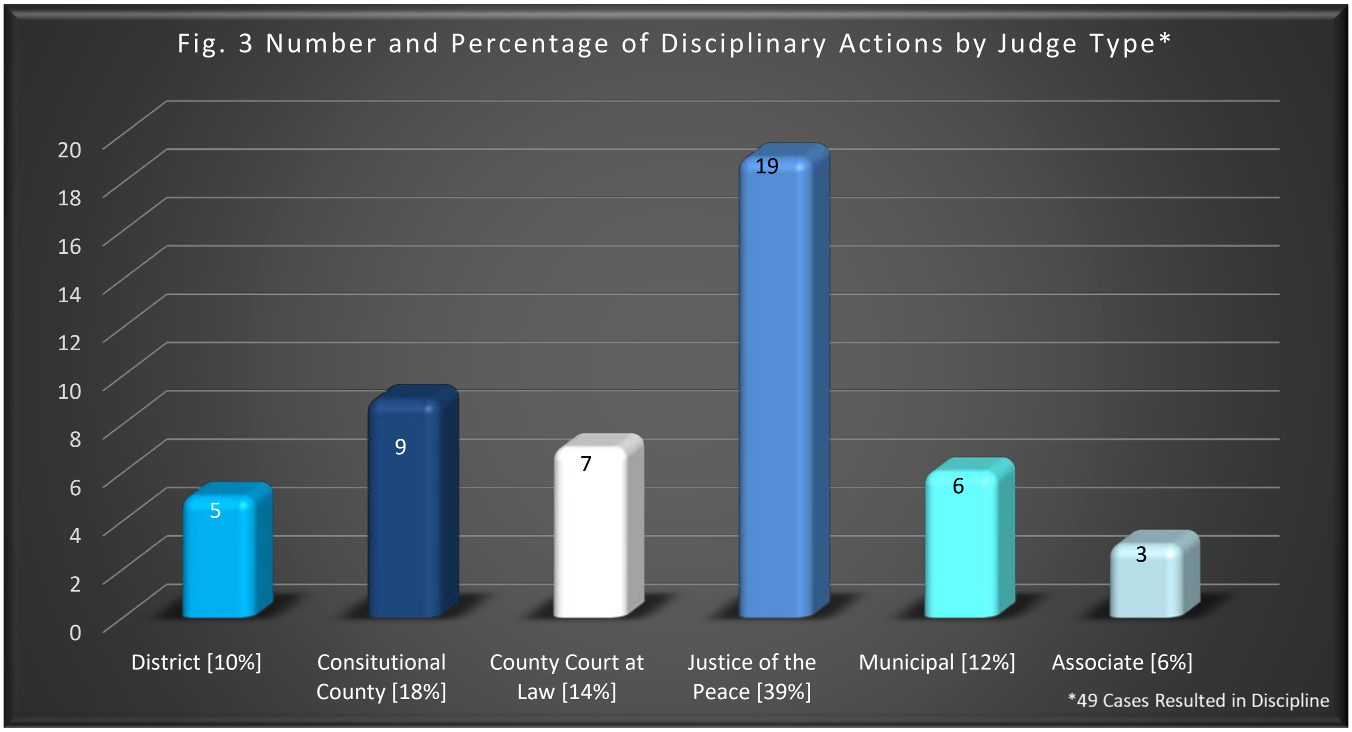


Fig. 2 Number and Percentage of Cases Filed by Judge Type

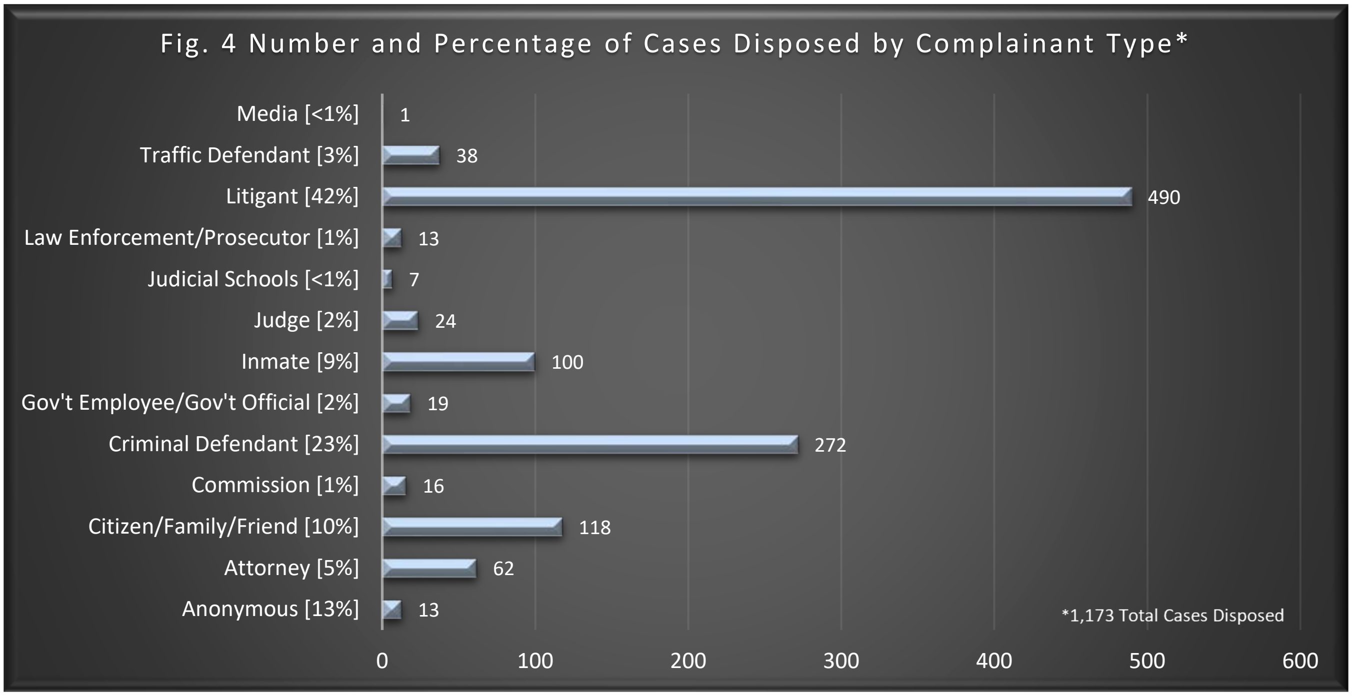
*925 Total Complaints Filed

Fig. 3 Number and Percentage of Disciplinary Actions by Judge Type*



*49 Cases Resulted in Discipline

Fig. 4 Number and Percentage of Cases Disposed by Complainant Type*



*1,173 Total Cases Disposed

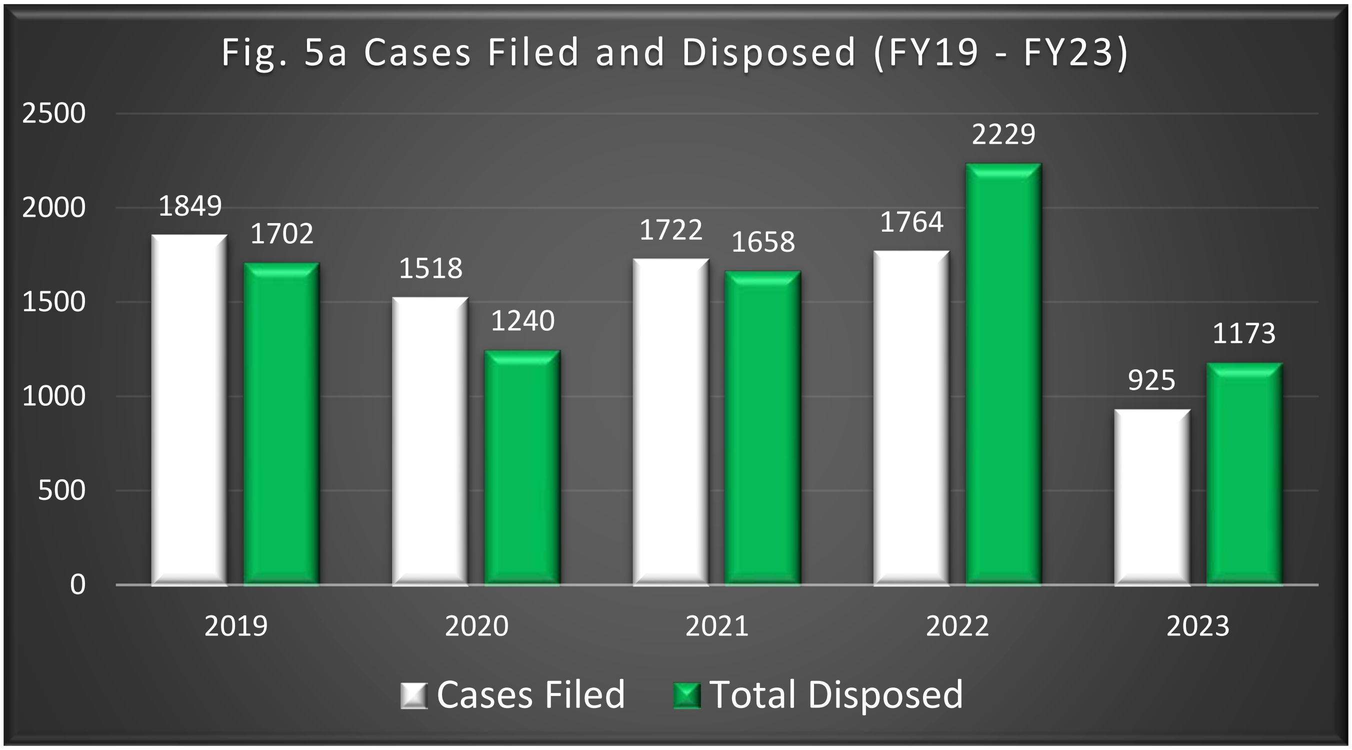


Fig. 5a Cases Filed and Disposed (FY19 - FY23)

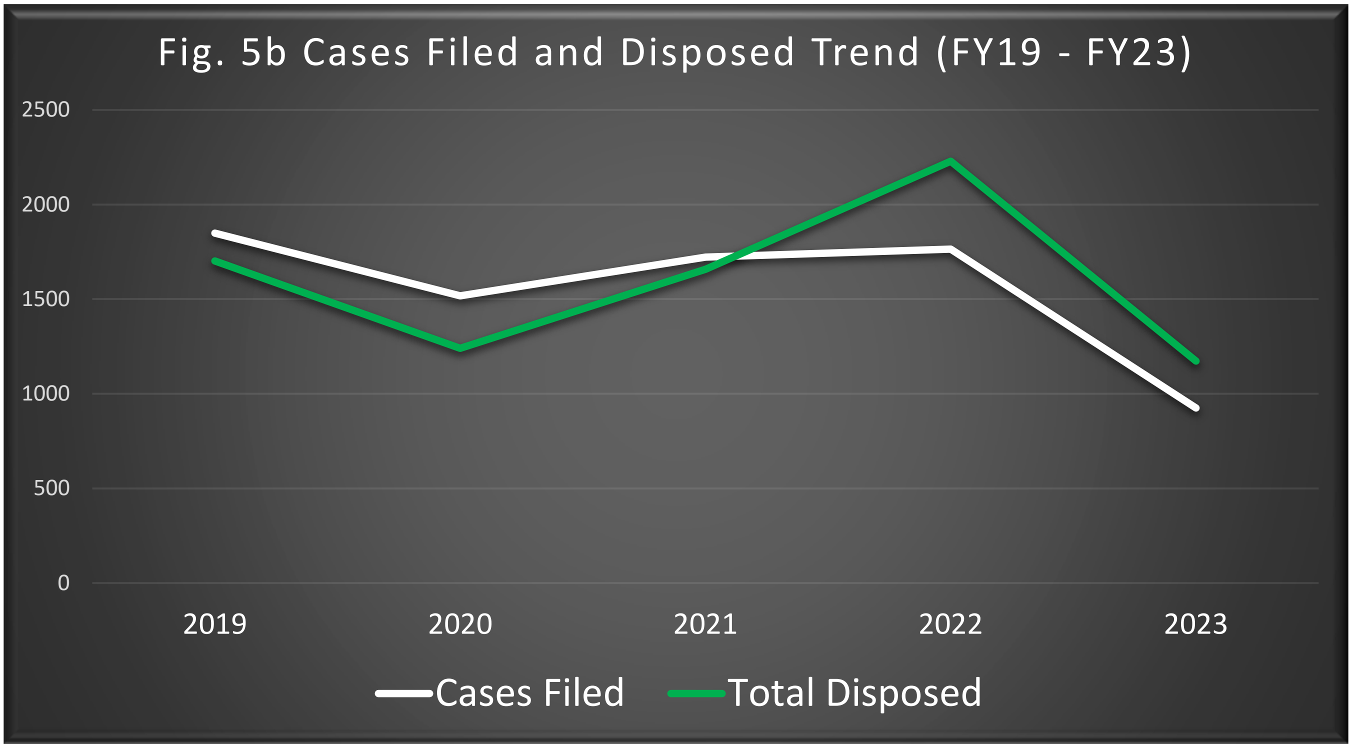


Fig. 5b Cases Filed and Disposed Trend (FY19 - FY23)

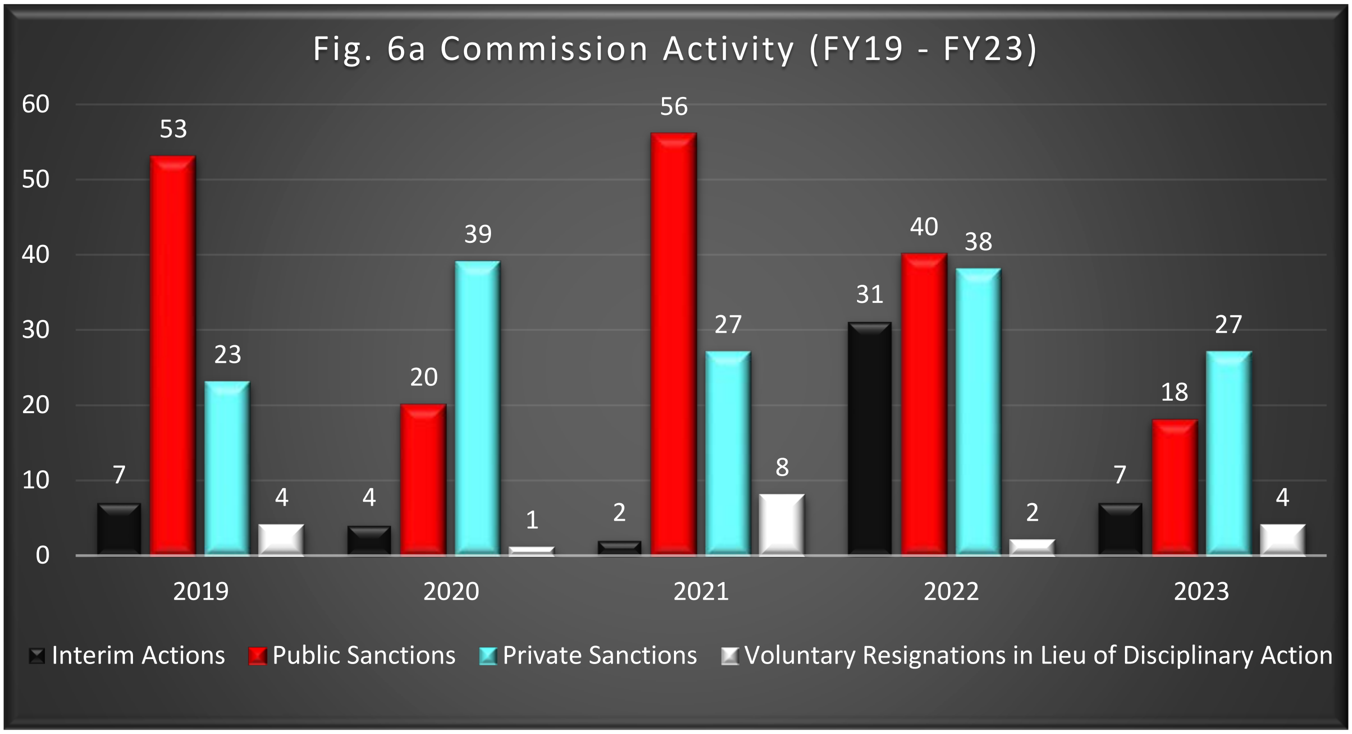


Fig. 6a Commission Activity (FY19 - FY23)

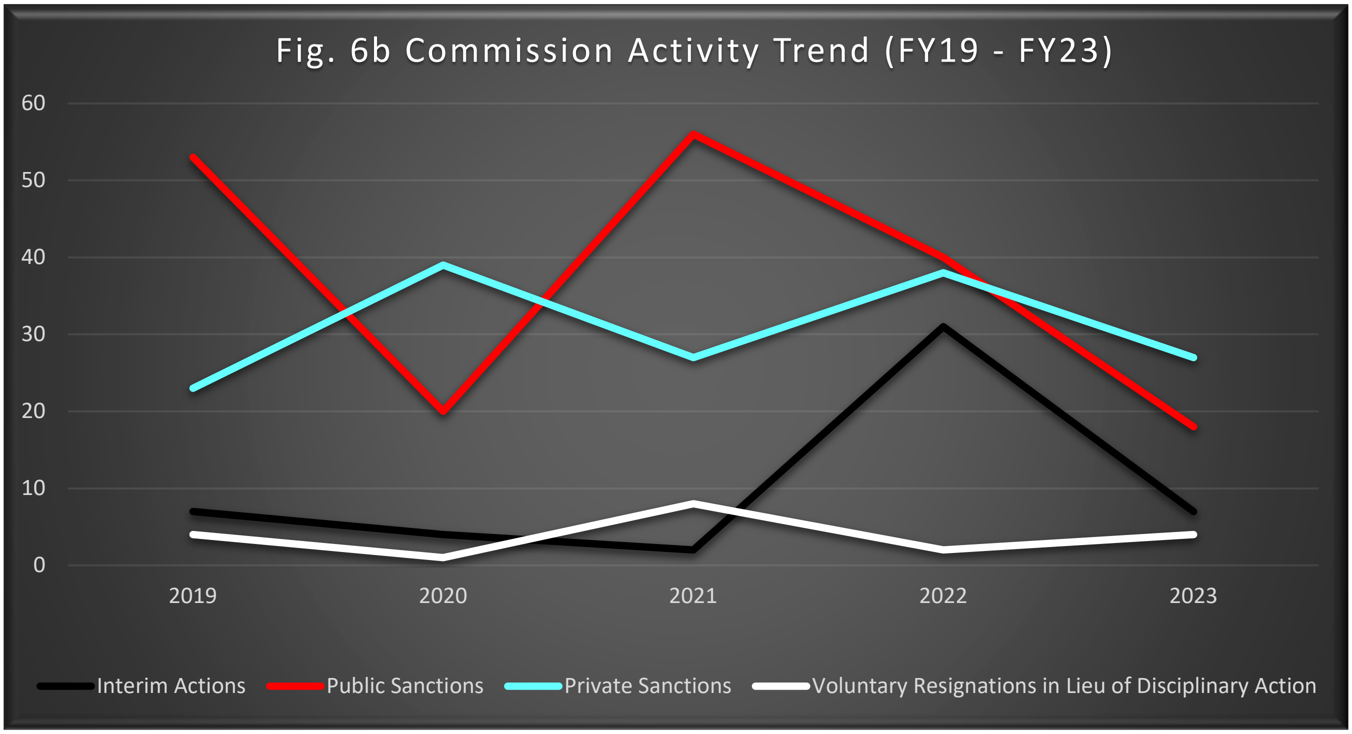


Fig. 6b Commission Activity Trend (FY19 - FY23)

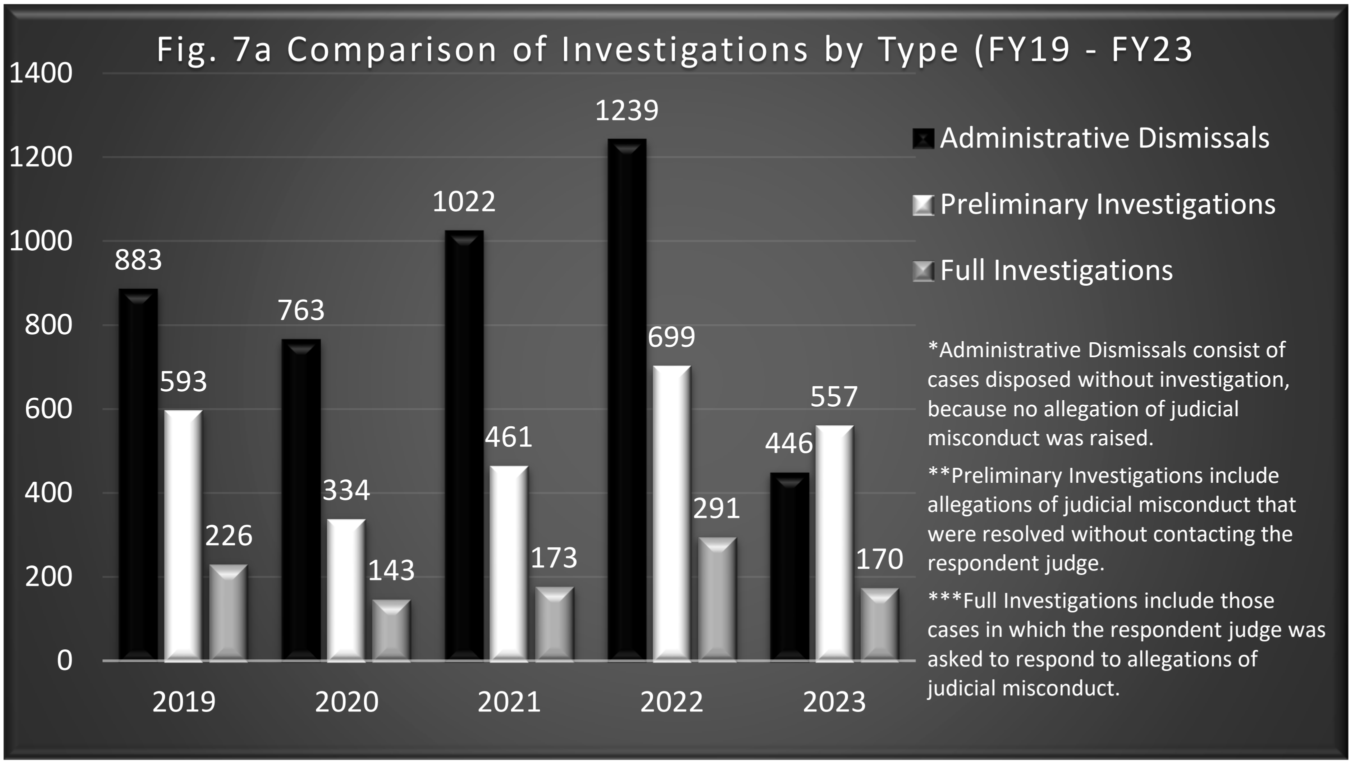


Fig. 7a Comparison of Investigations by Type (FY19 - FY23

*Administrative Dismissals consist of cases disposed without investigation, because no allegation of judicial misconduct was raised.

**Preliminary Investigations include allegations of judicial misconduct that were resolved without contacting the respondent judge.

***Full Investigations include those cases in which the respondent judge was asked to respond to allegations of judicial misconduct.

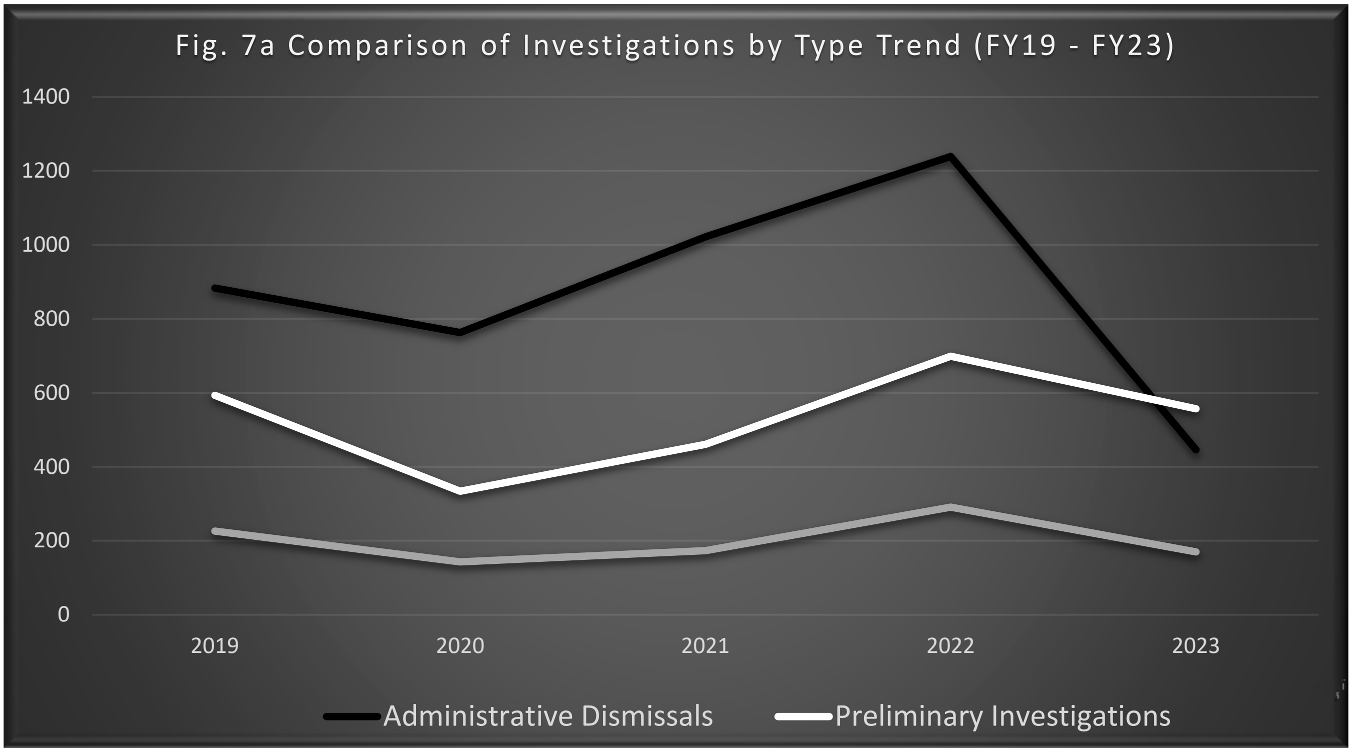


Fig. 7a Comparison of Investigations by Type Trend (FY19 - FY23)

EXAMPLES OF IMPROPER JUDICIAL CONDUCT

The following are examples of judicial misconduct that resulted in disciplinary action by the Commission in fiscal year 2023. These are illustrative examples of misconduct, and do not represent every disciplinary action taken by the Commission in fiscal year 2023. The summaries below are listed in relation to specific violations of the Texas Code of Judical Conduct, the Texas Constitution, and other statutes or rules. They are listed in no particular order of severity of the disciplinary action imposed, and may involve more than one violation. The full text of every public sanction is published on the Commission website. A copy of any public record relating to any public sanction may also be requested by contacting the Commission.

These sanction summaries are provided with the intent to educate and inform the judiciary and the public regarding misconduct that the Commission found to warrant disciplinary action in fiscal year 2023. The reader should note that the summaries provide only general information and may omit mitigating or aggravating facts the Commission considered when determining the level of sanction to be imposed. Additionally, the reader should not make any inference from the fact situations provided in these summaries.

It is important to remember that the purpose of judicial discipline is not solely to punish a judge for engaging in misconduct, but to protect the public by making clear that the Commission does not condone judicial conduct that violates the public trust. However, the reader should note that not every transgression reported to the Commission will result in disciplinary action. The Commission has broad discretion to determine whether disciplinary action is appropriate, and the degree of discipline to be imposed. Factors such as the seriousness of the transgression, whether there is a pattern of improper activity, and the effect of the improper activity on others or on the judicial system, will inform and impact the Commission's decision in each case. It is the Commission's sincere desire that providing this information will protect and preserve the public's confidence in the competence, integrity, impartiality and independence of the judiciary and further assist the judiciary in establishing, maintaining and enforcing the highest standards of conduct – both on the bench and in their personal lives.

ARTICLE V, Section 1-a(6)A, Texas Constitution: A judge may be disciplined for willful or persistent violation of the rules promulgated by the Supreme Court of Texas, willful violation of the code of Judicial Conduct, incompetence in performing the duties of office, or willful or persistent conduct that is clearly inconsistent with the proper performance of his duties or casts public discredit upon the judiciary or the administration of justice.

The judge engaged in willful and persistent conduct that cast public discredit upon the judiciary and the administration of justice when the judge made public statements that appeared to denigrate and demean the office to which the judge serves and lent the prestige of judicial office to advance the judge's own private interests by allowing the display/distribution of the judge's campaign materials outside the judge's office. [Violation of Canon 2B and Article V, Section 1-a(6)A of the Texas Constitution] *Private Reprimand and Order of Additional Education of a Justice of the Peace* (6/21/23).

The judge failed to comply with the law, maintain professional competence in the law and engaged in conduct that is clearly inconsistent with the proper performance of the judge's duties and cast public discredit upon the judiciary or the administration of justice by denying an appeal bond and failing to forward a case to the proper appellate court. [Violations of Canons 2A and 3B(2) of the Texas Code of Judicial Conduct and Article V, Section 1-a(6)A of the Texas Constitution.] *Private Reprimand of a Justice of the Peace* (3/2/23).

<u>CANON 2A</u>: A judge shall comply with the law and should act at all times in a manner that promotes public confidence in the integrity and impartiality of the judiciary.

The judge failed to comply with the law when the judge operated a motor vehicle while intoxicated which resulted in a car accident that caused damage to others, in violation of Section 49.04(a) of the Texas Penal Code. [Violation of Canon 2A of the Texas Code of Judicial Conduct and Article V, Section 1-a(6)A of the Texas Constitution.] *Public Warning of a District Judge* (8/16/23).

The judge failed to comply with the law and failed to maintain competence in the law when the judge questioned a defendant without his attorney present or contacting the defendant's attorney for permission to speak with the defendant either before or after the conversation and for failing to comply with the judge's reporting requirements pursuant to Section 113.022 and 114.044 of the Texas Local Government Code. [Violation of Canons 2A and 3B(2) of the Texas Code of Judicial Conduct and Article V, Section 1-a(6)A of the Texas Constitution.] *Public Reprimand of a Justice of the Peace* (8/2/23).

The judge failed to comply with the law when a member of the public was denied copies of court records, pursuant to a proper request, by a court clerk under the supervision of the judge. [Violation of Canon 2A of the Texas Code of Judicial Conduct.] *Private Order of Additional Education of a Municipal Court Judge* (6/21/23).

The judge failed to comply with law and maintain professional competence in the law by ignoring and failing to enforce mandates from an appellate court. [Violations of Canons 2A and 3B(2) of the Texas Code of Judicial Conduct.] *Private Warning of a District Judge* (3/2/23).

The judge failed to comply with the law and maintain professional competence in the law when the judge displayed the defendant's sensitive personal information during a Zoom hearing that was livestreamed on the Court's YouTube channel. [Violations of Canon 2A and 3B(2).] *Private Warning and Order of Additional Education of a County Court at Law Judge* (10/13/22).

<u>CANON 2B</u>: A judge shall not allow any relationship to influence judicial conduct or judgment. A judge shall not lend the prestige of judicial office to advance the private interests of the judge or others; nor shall a judge convey or permit others to convey the impression that they are in a special position to influence the judge.

The judge lent the prestige of judicial office to advance the judge's own private interest by maintaining a website advertising both the judge's private legal services and the judge's position as a justice of the peace. [Violation of Canon 2B] *Public Admonition and Order of Additional Education of a Justice of the Peace* (6/21/23).

The judge lent the prestige of judicial office to advance the private interests of others by actively interjecting himself into and interfering with the legal service of process of a warrant for seizure of cattle. [Violation of Canons 2B and 4A(1) of the Texas Code of Judicial Conduct.] *Public Reprimand of a County Judge* (8/16/23).

The judge failed to comply with the law and maintain competence in the law and lent the prestige of judicial office to advance the private interests of the judge and others when the judge appeared and voluntarily testified as a character witness on behalf of the judge's staff at the hearing on a motion to recuse the judge. [Violation of Canons 2A, 2B and 3B(2) of the Texas Code of Judicial Conduct.] *Private Order of Additional Education of a Probate Judge*. (1/3/23).

<u>CANON 3B(2)</u>: A judge should be faithful to the law and shall maintain professional competence in it. A judge shall not be swayed by partisan interests, public clamor, or fear of criticism.

The judge failed to comply with the law and failed to maintain professional competence in the law when the judge failed to complete the required judicial education for the 2020-2021 and 2021-2022 academic years and failed to cooperate with the Commission in violation of Section 33.001(b)(5) of the Texas Government Code. [Violations of Canons 2A and 3B(2) of the Texas Code of Judicial Conduct and Article V, Section 1-a(6)A of the Texas Constitution.] *Public Reprimand of a Justice of the Peace* (6/8/23).

The judge failed to comply with the law and maintain professional competence in the law, failed to perform judicial duties without bias or prejudice and failed to accord the plaintiff the right to be heard when the judge vacated a judgment, dismissed an eviction case and a perfected appeal based on extraneous information the judge received out of court and after the court's jurisdiction has expired. [Violations of Canons 2A, 3B(2), 3B(5) and 3B(8) of the Texas Code of Judicial Conduct and Article V, Section 1-a(6)A of the Texas Constitution.] *Private Order of Additional Education of a Justice of the Peace* (5/12/23).

The judge failed to comply with the law and maintain professional competence in the law when the judge failed to refer a Motion to Recuse to the presiding judge within the required three business days; failed to perform judicial duties without bias and prejudice and manifesting bias and prejudice through the judge's words and conduct toward the plaintiff while presiding over a guardianship case; denied the parties the right to be heard regarding the judge's improper *ex parte* communications with an attorney concerning a trust agreement; engaged in *ex parte* communications and allowed court personnel to engage in *ex parte* communications with one of the attorneys in the case. [Violations of Canons 2A, 3B(2), 3B(5), 3B(6) and 3B(8) of the Texas Code of Judicial Conduct.] *Private Warning and Order of Additional Education of a County Court at Law Judge* (5/12/23).

The judge failed to comply with the law and maintain professional competence in the law when the judge denied a litigant's Statement of Inability to Afford Payment of Court Costs without conducting a hearing or issuing a written order listing the reasons for such determination and denied a litigant the right to be heard regarding the denial. [Violations of Canons 2A, 3B(2), and 3B(8).] *Private Reprimand and Order of Additional Education of a Justice of the Peace* (5/12/23).

<u>CANON 3B(4):</u> A judge shall be patient, dignified and courteous to litigants, jurors, witnesses, lawyers and others with whom the judge deals in an official capacity, and should require similar conduct of lawyers, and of staff, court officials and others subject to the judge's direction and control.

The judge failed to be patient, dignified and courteous toward a court reporter regarding the court reporter's resignation from employment in the judge's court. [Violation of Canon 3B(4) of the Texas Code of Judicial Conduct] *Private Warning of a County Court at Law Judge* (6/21/23).

The judge failed to be patient, dignified and courteous towards a law enforcement officer by referring to the officer as a "dirty cop" and accusing the office of resolving a matter "illegally." The judge further cast reasonable doubt on the judge's capacity to act impartially as a judge by giving advice on a civil matter, that was not pending in the judge's court. [Violations of Canons 3B(4) and 4A of the Texas Code of Judicial Conduct and Article V, Section 1-a(6)A of the Texas Constitution.] *Private Reprimand and Order of Additional Education of a Justice of the Peace* (3/2/23).

The judge failed to be patient, dignified and courteous with whom the judge deals in an official capacity by the judge's poor management and treatment of the judge's court employees. [Violation of Canon 3B(4) of the Texas Code of Judicial Conduct and Article V, Section 1-a(6)A of the Texas Constitution.] *Private Admonition of a Justice of the Peace* (10/15/22).

CANON 3B(5): A judge shall perform judicial duties without bias or prejudice.

The judge failed to comply with the law and maintain professional competence in the law, when, after ejecting a criminal defense attorney, the judge compelled the attorney's client to proceed with the hearing in the absence of the attorney. The Commission further concluded that the judge failed to treat the attorney with patience, dignity and courtesy, performed judicial duties with bias against the attorney and his client, and failed to accord the attorney and his client the right to be heard according to law. [Violation of Canons 2A, 3B(2), 3B(4), 3B(5), 3B(6), and 3B(8) of the Texas Code of Judicial Conduct.] *Private Admonition of a District Judge* (3/2/23).

The judge failed to be patient, dignified and courteous, exhibited bias and prejudice towards a prosecutor when the judge ordered the prosecutor out of her courtroom because of an alleged "conflict of interest" and had the bailiff escort the prosecutor out of the courtroom, and failed to comply with the law and maintain professional competence in the law regarding the open court policy. [Violations of 2A, 3B(2), 3B(4) and 3B(5) of the Texas Code of Judicial Conduct.] *Private Reprimand of a Former District Court Judge* (11/7/22).

CANON 3B(8): A judge shall accord to every person who has a legal interest in a proceeding, or that person's lawyer, the right to be heard according to law. A judge shall not initiate, permit, or consider *ex parte* communications . . .

The judge denied an attorney the right to be heard on a pending motion and allowed court personnel to engage in improper *ex parte* communication with the attorney and provide advice as if the advice was authorized by the judge. [Violation of Canon 3B(8) of the Texas Code of Judicial Conduct.] *Private Admonition of a County Court at Law Judge* (5/12/23).

The judge failed to comply with the law or maintain competence in it, allowed a relationship with the prosecution to influence the judge's judicial conduct or judge, conveyed the impression that the prosecution was in a special position to influence the judge, for considering *ex parte* communications with an attorney for the state; and supplementing an appellate record with unfiled documents. [Violation of Canons 2A, 2B, 3B(2), 3B(8) and Article V, Section 1-a(6)A of the Texas Constitution.] *Private Reprimand and Order of Additional Education of a District Judge* (10/24/22).

CANON 5(2): A judge shall not authorize the use of his or her name endorsing another candidate for any public office.

The judge lent the prestige of judicial office to advance the interest of and authorizing the public use of the judge's name and judicial title to endorse a candidate in a special election by hosting a political event and making introductory remarks that a reasonable person, either in attendance at the event or watching a video of the judge's remarks on social media, would believe was the judge's public endorsement of the candidate. [Violation of Canons 2B and 5(2) of the Texas Code of Judicial Conduct.] *Private Admonition and Order of Additional Education of a District Court Judge.* (1/3/23).

COMMISSION MEMBERS PAST AND PRESENT

(Last Updated 11/29/23)

APPELLATE JUDGE MEMBERS

APPOINTED BY	NAME	DATES OF SERVICE	COMMENTS
Texas Supreme Court	Honorable Charles Barrow	66 - 69	4 Year Term
Texas Supreme Court	Honorable Spurgeon Bell	66 - 71	Served as Chair
Texas Supreme Court	Honorable Homer Stephenson	70 - 75	Served as Chair
Texas Supreme Court	Honorable Phil Peden	72 - 77	Served as Secretary Served as Chair
Texas Supreme Court	Honorable Edward Coulson	78 - 81	Served as Vice Chair
Texas Supreme Court	Honorable Charles L. Reynolds	78 - 81	Unexpired Term Served as Vice Chair
Texas Supreme Court	Honorable Esco Walter	75 - 77	
Texas Supreme Court	Honorable John Boyd	82 - 87	Served as Vice Chair Served as Chair
Texas Supreme Court	Honorable William Junell	77 – 81 81 - 83	Unexpired Term Reappointed Served as Chair
Texas Supreme Court	Honorable William Bass	89 - 94	Retired
Texas Supreme Court	Honorable William "Bud" Arnot	95 – 95 95 – 01	Unexpired Term Reappointed Served as Vice Chair Served as Chair
Texas Supreme Court	Honorable Joseph B. Morris	01 - 07	Served as Vice Chair Served as Chair
Texas Supreme Court	Honorable Jan P. Patterson	07 - 13	Served as Vice Chair
Texas Supreme Court	Honorable David Gaultney	11 – 13	Unexpired Term
Texas Supreme Court	Honorable Douglas S. Lang	13 – 18	Served as Chair Served as Vice Chair Served as Secretary
Texas Supreme Court	Honorable Lee Gabriel	19 – 19	Unexpired Term
Texas Supreme Court	Honorable David Schenck	20 – 22	Unexpired Term Served as Chair

COMMISSION MEMBERS PAST AND PRESENT

(Last Updated 11/29/23)

APPOINTED BY	NAME	DATES OF SERVICE	COMMENTS
Texas Supreme Court	Honorable Ken Wise	23 -	Unexpired Term

DISTRICT JUDGE MEMBERS

Texas Supreme Court	Honorable Connally McKay	66 – 68	Served as Vice Chair
Texas Supreme Court	Honorable Truett Smith	66 – 69	Served as Vice Chair
Texas Supreme Court	Honorable Clarence Guittard	68 – 69	Unexpired Term Served as Secretary Resigned (appointed Appellate Judge)
Texas Supreme Court	Honorable Howard Davison	68 – 75	Served as Vice Chair
Texas Supreme Court	Honorable R. C. Vaughan	69 – 71 71 – 77	Unexpired Term Reappointed Served as Vice Chair Served as Chair
Texas Supreme Court	Honorable Walter E. Jordan	78 – 81	Served as Chair
Texas Supreme Court	Honorable Darrell Hester	76 – 81	Served as Vice Chair Served as Chair
Texas Supreme Court	Honorable Raul Longoria	82 – 87	
Texas Supreme Court	Honorable Harry Hopkins	82 – 83 83 – 89	Unexpired Term Reappointed Served as Vice Chair Resigned (appointed Appellate Judge)
Texas Supreme Court	Honorable Homer Salinas	88 – 93	Served as Vice Chair
Texas Supreme Court	Honorable Merrill Hartman	93 – 99	Served as Vice Chair Served as Chair
Texas Supreme Court	Honorable Kathleen Olivares	99 – 05	Served as Vice Chair Served as Chair
Texas Supreme Court	Honorable Sid Harle	05 – 11	Served as Vice Chair Served as Chair
Texas Supreme Court	Honorable Orlinda L. Naranjo	11 - 18	

COMMISSION MEMBERS PAST AND PRESENT

(Last Updated 11/29/23)

APPOINTED BY	NAME	DATES OF SERVICE	COMMENTS
Texas Supreme Court	Honorable Ruben G. Reyes	18 - 20	Deceased
Texas Supreme Court	Honorable Gary L. Steel	21 -	Unexpired Term Serving as Chair

COUNTY COURT AT LAW MEMBERS

Texas Supreme Court	Honorable J. Ray Kirkpatrick	85 -89	New Position
Texas Supreme Court	Honorable Hilda Tagle	89 - 91 91 - 94	Unexpired Term Reappointed Resigned (elected District Judge)
Texas Supreme Court	Honorable Martin Chiuminatto	95 – 97 97 - 03	Unexpired Term Reappointed Served as Secretary
Texas Supreme Court	Honorable Michael R. Fields	03 - 09	Served as Vice Chair
Texas Supreme Court	Honorable M. Sue Kurita	10 - 15	Served as Vice Chair
Texas Supreme Court	Honorable David C. Hall	15 - 23	Unexpired Term Served as Secretary Served as Vice Chair Served as Chair
Texas Supreme Court	Honorable Carey F. Walker	23 -	Unexpired Term

CONSTITUTIONAL COUNTY JUDGE MEMBERS

Texas Supreme Court	Honorable Ernie Houdashell	07 – 09	New Position
Texas Supreme Court	Honorable Joel P. Baker	09 – 11 11 - 16	Unexpired Term Reappointed Served as Vice Chair Resigned (2016)
Texas Supreme Court	Honorable Tramer J. Woytek	16 – 17 17 - 20	Unexpired Term Reappointed Served as Secretary (Resigned 2020)
Texas Supreme Court	Honorable Lucy M. Hebron	21 - 22	Unexpired Term

COMMISSION MEMBERS PAST AND PRESENT

(Last Updated 11/29/23)

APPOINTED BY	**NAME**	**DATES OF SERVICE**	**COMMENTS**
Texas Supreme Court	Honorable Tano E. Tijerina	23 -	Unexpired Term

JUSTICE OF THE PEACE MEMBERS

Texas Supreme Court	Honorable Wayne LeCroy	78 – 83	New Position
Texas Supreme Court	Honorable James Dinkins	83 – 83	Unexpired Term
Texas Supreme Court	Honorable Jack Richburg	84 – 85 85 – 90	Unexpired Term Reappointed
Texas Supreme Court	Honorable Charles McCain	91 – 91	Unexpired Term
Texas Supreme Court	Honorable Tom Lawrence	91 – 97	Served as Vice Chair Served as Chair
Texas Supreme Court	Honorable Keith Baker	97 – 03	
Texas Supreme Court	Honorable Rex Baker	03 – 07	Served as Vice Chair Served as Chair Resigned
Texas Supreme Court	Honorable Tom Lawrence	07 – 09	Unexpired Term
Texas Supreme Court	Honorable Steven L. Seider	10 - 15	Served as Vice Chair Served as Chair
Texas Supreme Court	Honorable David M. Patronella	15 - 22	
Texas Supreme Court	Honorable Wayne Money	22 -	

MUNICIPAL JUDGE MEMBERS

Texas Supreme Court	Honorable Elinor Walters	85 – 91	New Position Served as Secretary
Texas Supreme Court	Honorable Bonnie Sudderth	91 – 96	Resigned (appointed District Judge)
Texas Supreme Court	Honorable Michael O'Neal	96 – 97 97 – 02	Unexpired Term Reappointed Resigned

COMMISSION MEMBERS PAST AND PRESENT

(Last Updated 11/29/23)

APPOINTED BY	NAME	DATES OF SERVICE	COMMENTS
Texas Supreme Court	Honorable Monica A. Gonzalez	02 – 03 03 – 09	Unexpired Term Reappointed Served as Vice Chair Served as Chair Resigned in '09 (appointed to CCL)
Texas Supreme Court	Honorable Edward J. Spillane, Jr.	09 – 15	
Texas Supreme Court	Honorable Catherine N. Wylie	15 - 19	Served as Vice Chair Served as Chair
Texas Supreme Court	Honorable M. Patrick Maguire	20 - 22	Unexpired Term
Texas Supreme Court	Honorable Chace A. Craig	23 -	Unexpired Term

PUBLIC MEMBERS

Governor	William Blakemore	66 - 69	
Governor	Lewis Bond	66 - 70	
Governor	Robert Whipkey	66 - 72	
Governor	F. Howard Walsh	70 - 74	
Governor	Vernon Butler	70 - 75	
Governor	F. Ray McCormick	73 - 77	
Governor	Carl Dillard	74 - 81	Served as Secretary
Governor	Crawford Godfrey	76 - 81	
Governor	Mike Maros	78 - 83	Served as Secretary Replaced McCormick
Governor	Robert Rogers	81 - 85	
Governor	Scott Taliaferro	81 - 85	Served as Secretary
Governor	Col.(R) Nathan I. Reiter	81 - 87	Served as Secretary Resigned 5/14/87
Governor	Max Emmert, III	83 - 89	

COMMISSION MEMBERS PAST AND PRESENT

(Last Updated 11/29/23)

APPOINTED BY	NAME	DATES OF SERVICE	COMMENTS
Governor	Lowell Cable	85 - 91	
Governor	Gary Griffith	88 - 91	Unexpired Term
Governor	Dr. Roderick Nugent	87 - 93	
Governor	Al Lock	89 - 95	Served as Secretary
Governor	Carol MacLean	94 - 97	Resigned
Governor	Rosa Walker	91 - 97	
Governor	Jean Birmingham	93 - 99	
Governor	L. Scott Mann	95 - 01	Served as Vice Chair Served as Chair
Governor	Dee Coats	98 - 03	Served as Secretary
Governor	Gilbert M. Martinez	98 - 03	
Governor	Wayne Brittingham	00 - 01	Resigned
Governor	Faye Barksdale	01 - 07	
Governor	R.C. Allen III	02 - 05	
Governor	Ann Appling Bradford	03 - 09	Served as Secretary
Governor	Buck Prewitt	04 - 06	Resigned
Governor	Gilbert Herrera	05 – 05	Resigned
Governor	Janelle Shepard	05 – 11	Served as Secretary
Governor	Cynthia Tauss Delgado	07 - 07	Resigned
Governor	William Lawrence	07 – 09	Unexpired Term
Governor	Conrado De La Garza	08 - 08	Resigned
Governor	Karry Matson	09 - 13	Unexpired Term
Governor	Patty Johnson	09 – 11 11 - 18	Unexpired Term Reappointed Served as Secretary
Governor	Martha Hernandez	10 - 15	
Governor	Diane DeLaTorre Threadgill	10 - 15	
Governor	Valerie E. Ertz	11 - 17	Served as Secretary Served as Chair
Governor	David M. Russell	13 - 19	
Governor	Darrick L. McGill	17 - 21	

COMMISSION MEMBERS PAST AND PRESENT

(Last Updated 11/29/23)

APPOINTED BY	NAME	DATES OF SERVICE	COMMENTS
Governor	Sujeeth B. Draksharam	17 - 23	
Governor	Maricela Alvarado	18 - 19	Resigned
Governor	Amy Suhl	18 - 19	Resigned
Governor	Valerie Ertz	19 -	Unexpired Term
Governor	Frederick C. Tate	19 - 23	Unexpired Term Serving as Secretary
Governor	Janis Holt	19 -	Served as Secretary Serving as Vice-Chair
Governor	Kathy P. Ward	21 -	
Governor	Andrew M. “Andy” Kahan	23 -	Unexpired Term
Governor	Clifford T. Harbin	23 -	Unexpired Term

ATTORNEY MEMBERS

State Bar	J. E. Abernathy	66 – 69	
State Bar	Fred Werkenthin	66 – 72	Served as Secretary
State Bar	Donald Eastland	69 – 75	Served as Chair
State Bar	Robert C McGinnis	71 – 77	
State Bar	O. J. Weber	75 – 81	Served as Vice Chair
State Bar	W. Truett Smith	78 – 83	Served as Chair
State Bar	Robert Parsley	81 – 87	
State Bar	Jamie Clements	83 – 89	Served as Vice Chair
State Bar	Charles Smith	87 – 93	Served as Chair
State Bar	Charles R. Dunn	89 – 95	Served as Chair
State Bar	Jack Pasqual	93 – 99	
State Bar	Blake Tartt	95 – 01	

COMMISSION MEMBERS PAST AND PRESENT

(Last Updated 11/29/23)

APPOINTED BY	NAME	DATES OF SERVICE	COMMENTS
State Bar	Wallace Jefferson	99 – 01	Resigned (appointed Supreme Court Justice)
State Bar	Ron Krist	01 – 07	
State Bar	James Hall	01 – 05	Unexpired Term Served as Vice Chair Served as Chair
State Bar	Jorge Rangel	05 – 11	Served as Vice Chair Served as Chair
State Bar	Tom Cunningham	07 – 13	Served as Vice Chair Served as Chair
State Bar	Ricky A. Raven	11 - 17	Served as Secretary
State Bar	Demetrius K. Bivins	13 - 19	
State Bar	Ronald E. Bunch	17 -	Served as Secretary Served as Vice-Chair
State Bar	Steve Fischer	19 - 20	Resigned
State Bar	Clifton Roberson	21 -	Unexpired Term

Tab AA

From: Victoria Katz
To: Rulescomments; Blake Hawthorne
Subject: TRCP 4 clarification
Date: Wednesday, June 5, 2024 1:58:37 PM
Attachments: image538625.png

Good afternoon,

Although TRCP 4 does not have amendments pending and is not out for comment, we are writing in the hopes of receiving clarification of the term “next day” as used therein. If there is a more appropriate person/e-mail to whom to direct our question, we would appreciate being provided that information.

TRCP 4 says, “The last day of the period so computed is to be included, unless it is a Saturday, Sunday, or legal holiday, in which event the period runs until the end of the next day which is not a Saturday, Sunday, or legal holiday.” [Emphasis added.] However, the term “next day” is not defined.

When counting forward from an event there is little ambiguity as to what is considered the "next day" under TRCP 4. However, when counting backwards, if the deadline falls on a weekend or holiday, it is uncertain what is the "next day." Is the next day the preceding day (backward), counting in the same direction as the initial time period, or is it the succeeding day (forward)? For example, TRCO 166a(c) says that the deadline to file and serve opposing affidavits and other responses to a summary judgment motion is “not later than seven days prior to the day of hearing.” If the 7th day prior to the hearing falls on a weekend or holiday, would the deadline move forward to the 6th day prior to the hearing, or backwards to the 8th day prior to the hearing?

We are aware of the case *Hammonds v. Thomas*, 770 S.W.2d 1, 2-3 (Tex. App.—Texarkana 1989, no writ), which ruled that the summary judgment response deadline moves forward to the 6th day prior to the hearing, however it is our understanding that at least one later case disagreed with this ruling. We also are aware of the case *Lewis v. Blake*, 876 S.W.2d 314, 316 (Tex. 1994), which ruled that TRCP 4 applies to all deadlines, not just forward counting deadlines. The *Lewis* court, however, was limited to whether extra time should be added to the deadline to serve notice of a motion for summary judgment when the notice is served by mail. It did not address what direction a deadline moves under TRCP 4 when the last day falls on a weekend or holiday.

Further, to avoid confusion in the future regarding backward counting deadlines in Texas state courts, we respectfully propose that the Texas courts amend TRCP 4 to define the term “next day” for both forward and backward counting deadlines. A model for such amendment might be the amendment to the Federal Rules of Civil Procedure (“FRCP”), which was made to clarify a very similar ambiguity. FRCP 6(a)(5) now says, “The ‘next day’ is determined by continuing to count forward when the period is measured after an event and backward when measured before an event.“

Aderant CompuLaw is a software-based court rules publisher providing deadline information to many firms practicing in the Texas state courts. Because this ambiguity in TRCP 4 is causing considerable confusion for our users, we would greatly appreciate any information you are able to provide us regarding this issue.

Sincerely,

Victoria Katz
Senior Rules Attorney

Email: victoria.katz@aderant.com
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Tab BB

Texas Supreme Court
Advisory Committee

Memo

To:	Texas Supreme Court Advisory Committee (SCAC)
From:	Subcommittee on Rules 1-14c
Date:	August 6, 2024
Re:	Proposed Amendment to Rule 4 to define “next day”

Request to Amend Rule 4

The subcommittee on Rules 1-14c has reviewed the request by Aderant Computer Law, a software-based courts publisher providing deadline information to law firms, that we amend Rule 4 to define “next day.” TRCP 4 does not define next day. It states:

> The last day of the period so computed is to be included, unless it is a Saturday, Sunday, or legal holiday, in which event the period runs until the end of the next day which is not a Saturday, Sunday, or legal holiday.

Tex. R. Civ. P. 4. In contrast, FRCP 6(a)(5) defines next day:

> ***“Next Day” Defined.*** The “next day” is determined by continuing to count forward when the period is measured after an event and backward when measured before an event.

Background

Some Texas rules set deadlines before a hearing or event. *See, e.g.,* TRCP166a(c) (requiring summary-judgment motion to be “filed and served at least twenty-one days before the time specified for the hearing”). Others set deadlines after an event. *See., e.g.,* TRCP329b(a) (requiring new-trial motion to be “filed prior to or within thirty days after the judgment or other order complained of is signed”).

As noted by Aderant in its request for an amendment:

> When counting forward from an event there is little ambiguity as to what is considered the “next day” under TRCP 4. However, when counting backwards, if the deadline falls on a weekend or holiday, it is uncertain what is the “next day.” Is the next day the preceding day (backward), counting in the same direction as the initial time period, or is it the succeeding day (forward)? For example, TRC[P 1]66a(c) says that the deadline to file and serve opposing affidavits and other responses to a summary judgment motion is

> “not later than seven days prior to the day of hearing.” If the 7th day prior to the hearing falls on a weekend or holiday, would the deadline move forward to the 6th day prior to the hearing, or backwards to the 8th day prior to the hearing?
>
> We are aware of the case *Hammonds v. Thomas,* 770 S.W.2d 1, 2-3 (Tex. App--Texarkana 1989, no writ), which ruled that the summary judgment response deadline moves forward to the 6th day prior to the hearing, however it is our understanding that at least one later case disagreed with this ruling. We also are aware *of* the case *Lewis v. Blake,* 876 S.W.2d 314,316 (Tex. 1994), which ruled that TRCP 4 applies to all deadlines, not just forward counting deadlines. The *Lewis* court, however, was limited to whether extra time should be added to the deadline to serve notice of a motion for summary judgment when the notice is served by mail. It did not address what direction a deadline moves under TRCP 4 when the last day falls on a weekend or holiday.

Texas courts have split on “the applicability of Rule 4 to time periods that are counted backwards in time, as opposed to those counted forward,” as observed by *Reichhold Chemicals, Inc. v. Puremco Mfg. Co.*, 854 S.W.2d 240, 246–47 (Tex. App.—Waco 1993, writ denied):

> *Compare Hammonds v. Thomas,* 770 S.W.2d 1, 3 (Tex. App.—Texarkana 1989, no writ) (holding that Rule 4 applies to Rule 166a, so that controverting affidavits required to be filed seven days before a summary-judgment hearing could be filed on July 5 when the seventh day before the hearing was July 4) *with Old Republic Ins. Co. v. Wuensche,* 782 S.W.2d 346, 348–49 (Tex. App.—Fort Worth 1989, writ denied) (affirming the refusal of an amended pleading and holding that Rule 4 does not apply to the requirement of Rule 93 that a verified denial be filed “not less than seven days before ... trial”).

Id. at 247. *Reichold* followed *Old Republic* and held that that “’Rule 4 assumes that time calculations are not calculated backwards from a date ... [but] start with some act, event, or default” and that the rule was intended to *extend* time periods, not *shorten* them.” *Id.*

Reichold was later criticized by the Fourteenth Court of Appeals as inconsistent with a subsequent Texas Supreme Court decision in *Lewis v. Blake*. *Melendez v. Exxon Corp.*, 998 S.W.2d 266, 275–76 (Tex. App.—Houston [14th Dist.] 1999, no pet.); *see also Sosa v. Central Power & Light,* 909 S.W.2d 893, 895 (Tex. 1995) (reiterating that *Lewis* held Rule 4 applies to any period of time prescribed by the rules of procedure and holding that Rule 4 applies to the time period in Rule 63 regarding amendment of pleadings). The *Melendez* court counted forward, as the court did in *Sosa*, and thus held that the supplementation of discovery responses was timely.

Aderant suggested that Texas adopt a clarifying rule like Federal Rule of Civil Procedure 6(a)(5), which defines next day and removes any ambiguity. It states:

> ***“Next Day” Defined.*** The “next day” is determined by continuing to count forward when the period is measured after an event and backward when measured before an event.

Fed. R. Civ. P. 6(a)(5).

Recommendation

We unanimously agreed that this definition should be added to our Rule 4.