RULES SUGGESTION
to the
ADVISORY COMMITTEE ON CIVIL RULES
and its
RULE 7.1 SUBCOMMITTEE

A NECESSARY DISCLOSURE: WHY RULE 7.1 SHOULD PROVIDE JUDGES INFORMATION ABOUT NON-PARTY CONTINGENT FINANCIAL INTERESTS THAT COULD REQUIRE RECUSAL

March 14, 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 ("Committee") and its Rule 7.1 Subcommittee ("Subcommittee").

Introduction

Non-party financial investments tied to the outcome of specific litigation can present a judge with the same duty to recuse as owning stock in a party to the lawsuit. For example, a judge who owns (or whose spouse owns) shares in a company that either provides third-party litigation funding ("TPLF"), or invests in a company that does, should know whether that company stands to benefit directly from the judgment or settlement in one of her cases. Because TPLF arrangements can mean that an investor is effectively a real party in interest, the Subcommittee should amend Federal Rule of Civil Procedure ("FRCP") 7.1 to require disclosures that would "better inform judges of circumstances that might trigger the statutory duty to recuse"[3] by revealing non-party financial investments contingent on the outcomes of cases. Such non-party

[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] Memo from Hon. Robin L. Rosenberg, Chair, Advisory Committee on Civil Rules, to Hon. John D. Bates, Chair, Committee on Rules of Practice and Procedure, Dec. 8, 2023, Agenda Book, Committee on Rules of Practice and Procedure, Jan. 4, 2024, https://www.uscourts.gov/sites/default/files/2024-01_agenda_book_for_standing_committee_meeting_final_0.pdf (Memo to Standing Committee), 307.

financial investments are pervasive in federal district courts, and it is increasingly acknowledged that judges should know about them.[4]

Amending Rule 7.1 to include non-party disclosures would not only provide judges with much-needed information informing the duty to recuse, but also would be consistent with the Chief Justice's highly public call for "greater attention to promoting a culture of compliance" in the federal judiciary,[5] which was inspired by the *Wall Street Journal*'s reporting of 685 instances of conflicts of interest.[6]

I. JUDGES SHOULD KNOW WHETHER THEY HAVE FINANCIAL INTERESTS IN THE NON-PARTIES WHOSE RIGHTS AND OBLIGATIONS ARE CONTINGENT ON THE OUTCOME OF THE CASE

Federal judges are required by statute[7] and the Code of Conduct for Federal Judges[8] to recuse when they know they have a financial interest that would be substantially affected by the outcome of the proceeding. This responsibility applies not only to interests in the subject matter or parties, but also to "any other any other interest that could be substantially affected by the outcome of the proceeding."[9] It relates to financial interests "however small"[10] and extends beyond actual conflicts of interest to include any "appearance of impropriety."[11] To comply with these provisions, judges should know more than whether they might have a financial interest in a party; they should also know whether they have a financial interest in a non-party company or fund that has investments contingent upon the outcome of a case.

II. JUDGES SHOULD KNOW WHEN TPLF INVESTMENT AGREEMENTS GIVE NON-PARTIES THE RIGHT TO RECEIVE PROCEEDS FROM JUDGMENTS AND SETTLEMENTS

As the Subcommittee is aware, "the increasing prevalence of third-party litigation funding (especially by entities that also engage in other business) may also serve to create interests in the litigation of which a judge is not aware."[12] Such interests are very common and substantial; there are $11 billion worth of TPLF investments in litigation outcomes in the United States

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[4] *See* N.D. Tex. Civ. R. 3.1(c) and 3.2 (e) (requiring "a complete list of all person, associations of person, firms, partnerships, corporations, guarantors, insurers, affiliates, parent or subsidiary corporations, or other legal entities that are financially interested in the outcome of the case"). *See also* D. N.J. Civ. R. 7.1.1 (requiring disclosure statement from "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").

[5] 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.

[6] *Id*. at 3.

[7] 28 U.S.C. § 455(b)(4).

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

[9] 28 U.S.C. § 455(b)(4).

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

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

[12] Memo to Standing Committee at 310.

today, according to a recent survey.[13] These investments exist in litigation at all stages,[14] in many federal courts, and in cases dealing with a wide variety of subject matters. These contingent financial investments are held by public companies, private companies, individuals, asset managers (including family offices), hedge funds, and institutions,[15] including both non-US individuals[16] and sovereign wealth funds.[17]

The nature of these non-party investments is important: Litigation investors' interests are 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."[18] Consequently, a judge's financial interest in a company making litigation investments has the same importance as a judge's financial interest in an actual party. Judges should know when such contingent interests are present in their cases in order to be able to recuse.

TPLF agreements are no longer confined to obscure forms of investment. Rather, TPLF has become a mainstream vehicle, invested in by public companies and recommended to individuals by financial advisors as an asset class even within individual retirement accounts because it is not correlated to stock and bond market performance. Thus, a recusal on this basis—which is required not only when a judge holds a "substantial interest" in the outcome of litigation before her, but any financial interest "however small"[19]—is much more likely than it was even a few years ago, especially given that TPLF agreements have exploded in popularity in federal district courts.

III. THE 50 LOCAL RULES THAT REQUIRE MORE DISCLOSURES THAN RULE 7.1 ARE FAILING TO INFORM JUDGES ABOUT THE NON-PARTY CONTINGENT FINANCIAL INTERESTS IN THEIR CASES

The fact that 50 of the 94 districts have local rules requiring more robust disclosures than Rule 7.1[20] indicates that many judges want more information than is currently required. But the checkerboard of local rules is not resulting in disclosures of direct, non-party financial

[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."). 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.").

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

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

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

[17] Burford 2021 Annual Report at 12.

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

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

[20] Memo to Standing Committee at 310.

interests.[21] 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."[22] But compliance is another matter. 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."[23] Indeed, the largest non-party TPLF funders "disagree about the extent of disclosure obligations."[24] Adding to the confusion, "[c]ompliance with these local rules is difficult to ascertain because district courts have not drafted their Local Rule 7.1 in a uniform manner."[25] As a result, the information judges receive about TPLF and other non-party contingent financial interests is a function of where the particular case is pending. In the absence of uniform guidance, more district courts are starting to act. The District of New Jersey recently adopted a local rule expressly requiring the disclosure of TPLF-related information at the outset of a case.[26] The Northern District of California adopted a standing order requiring TPLF disclosure in class action cases.[27] Most recently, the chief judge of the District of Delaware issued a standing order requiring TPLF disclosure in all civil cases in his court.[28] Uniform FRCP guidance is needed.

IV. JUDGES SHOULD KNOW ABOUT NON-PARTY FINANCIAL INTERESTS IN THEIR CASES FOR MANY REASONS BEYOND RECUSAL

Beyond the issue of recusals, judges have many other reasons to know about the existence of non-parties that hold financial interests in the outcomes of their cases.[29]

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[21] 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, 209-29, https://www.uscourts.gov/sites/default/files/2018-04-civil-rules-agenda-book.pdf.

[22] *Id*. at 209.

[23] 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.").

[24] *Id*. at 213.

[25] *Id*. at 214.

[26] *See* D.N.J. L. Civ. R. 7.1.1, https://www.njd.uscourts.gov/sites/njd/files/completelocalRules.pdf.

[27] *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").

[28] 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.

[29] *See* Lawyers for Civil Justice and the U.S. Chamber of Commerce Institute for Legal Reform, *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*, Sept. 8, 2022, https://www.uscourts.gov/sites/default/files/22-cv-m_suggestion_from_lcj_and_ilr_-_rule_16c2_0.pdf and Letter from Lisa A. Rickard, President, U.S. Chamber Institute for Legal Reform, *et al.* to Rebecca A. Womeldorf, Secretary, Committee on Rules of Practice and Procedure, June 1, 2017, https://www.uscourts.gov/sites/default/files/17-cv-o-suggestion_ilr_et_al_0.pdf.

Settlement Authority

Judges should know whether non-parties should participate in settlement conferences due to their authority or influence over resolution decisions. FRCP 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."[30] The 1993 Committee Notes to Rule 16 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."[31] Courts recognize the power to require decision makers to be available at pre-trial conferences.[32] There are compelling examples of litigation investors being vested with authority to influence or control litigation decisions, including with regard to settlement. Specifically:

- In *Boling v. Prospect Funding Holdings, LLC*,[33] the U.S. Court of Appeals for the Sixth Circuit concluded that the terms of the TPLF 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*,[34] 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."[35]

- 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."[36]

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[30] Fed. R. Civ. P. 16 advisory committee notes to 1993 amendment.
[31] *Id*. 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."
[32] *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.").
[33] 771 F. App'x 562, 579-80 (6th Cir. 2019).
[34] Compl. ¶ 35, No. 1:18-cv-12404-ALC, ECF No. 1 (S.D.N.Y. Dec. 31, 2018).
[35] *Id.* ¶ 124.
[36] 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,

- In the putative class action *Gbarabe v. Chevron Corp.*,[37] the TPLF 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."[38]

- And in a separate Chevron litigation, the TPLF agreement "provide[d] control to the Funders" through the "installment of 'Nominated Lawyers'"—lawyers "selected by the Claimants with the ***Funder's approval***.'"[39]

An amendment to Rule 7.1 requiring disclosure of TPLF interests would help judges determine when a non-party has authority over settlement decisions (in whole or in part), allowing the court to determine whose participation to require in settlement negotiations between the parties. Absent disclosure, a funder's presence as a player in the settlement process likely will remain hidden.

The Parties' Resources

FRCP 26(b)(1) defines the scope of discovery to include consideration of "the parties' resources."[40] A judge who is ruling on a discovery scope question therefore might want to consider non-party financial investments in the case, which are plainly relevant to the parties' resources. For the same reasons, a judge fashioning a protective order—particularly one that allocates expenses pursuant to Rule 26(c)(1)(B)—might want to consider whether a non-party holds a direct stake in any proceeds from the case. Similarly, a court contemplating an appropriate sanction under Rule 37 should know if the case is being funded pursuant to TPLF, and whether an investor or other non-party is making or influencing litigation decisions. 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. A Rule 7.1 disclosure requirement would benefit judges by indicating when it might be appropriate for further inquiry.

Conclusion

Judges should consider a great deal more than Rule 7.1 requires parties to disclose—and the discrepancy is even greater with respect to non-party investments. The statutory and ethical duties apply equally to all financial interests directly contingent on the outcomes of cases, not

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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)).

[37] No. 14-cv-00173-SI, 2016 U.S. Dist. LEXIS 103594, at *6 (N.D. Cal. Aug. 5, 2016).

[38] 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).

[39] Maya Steinitz, *The Litigation Finance Contract*, 54 Wm. & Mary L. Rev. 455, 472 (2012) (emphasis added) (footnote omitted). *See also*, Jennifer A. Trusz, *Full Disclosure? Conflicts of Interest Arising from Third-Party Funding in International Commercial Arbitration*, 101 Geo. L.J. 1649, 1650 (2013).

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

just to those of the parties, so it would be inaccurate to conclude that "[t]he TPLF set of issues is probably separate"[41] from Rule 7.1. The Subcommittee should amend Rule 7.1 to require disclosure of non-party financial investments tied directly to the outcome of a particular case, specifically including such interests arising from TPLF contracts.

[41] Advisory Committee on Civil Rules, Draft Minutes, Oct. 17, 2023, 11, Agenda Book, Committee on Rules of Practice and Procedure, Jan. 4, 2024, 347, https://www.uscourts.gov/sites/default/files/2024-01_agenda_book_for_standing_committee_meeting_final_0.pdf.