

Northern District of California Leads the Way on Requiring Disclosure of Third-Party Litigation Financing

Client Alert

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The Northern District of California is considering an amendment to its rules that would make it the first district court in the United States to require that parties to a civil suit disclose the participation of third-party funding.

A federal district court in California may soon require litigants to disclose secret lending from third-party financiers. Third-party litigation funding is a growing phenomenon whereby capital investment firms provide non-recourse loans to plaintiffs to fund the costs of litigation. These loans are usually meant to pay for expert fees and discovery costs and are only enforceable if the plaintiff recovers. Interest rates on these loans regularly exceed 15 percent annually,¹ and we have heard of funding agreements with interest rates as high as 30 percent. The increase in third-party financing has ignited controversy about the practice itself as well as its disclosure.

The Superior Court of Pennsylvania recently concluded that a litigation funding arrangement was unenforceable because it violated Pennsylvania's prohibition on champerty, a common-law doctrine that aims to prevent frivolous lawsuits by disallowing certain outsider participation in cases.² Other challenges to litigation financing will likely follow. Meanwhile, the Northern District of California is considering an amendment to its rules that would make it the first district court in the United States to require that parties to a civil suit disclose the participation of third-party funding.

There has been a recent influx of major litigation funders to California. Bentham IMF, the American arm of an Australian capital investment firm, opened its California office in November 2015, and there are reports that Longford Capital Management, a Chicago-based firm, is taking steps towards opening an office in California.³ The increase in outside funding and its potential effect on class actions and multidistrict litigations has not been well-received by some district courts in California. In the Northern District of California, Chevron is defending a class action against 12,500 Nigerian fishermen who allege injury from an offshore explosion of a drilling rig. Concerned that the litigation was being driven by the interests of unidentified third parties who were not known to the court, Chevron moved for and obtained an order for the production of all third-party funding agreements.⁴

Northern District of California Civil Local Rule 3-15 now requires all parties in a civil matter to disclose "entities other than the parties themselves" who have any interest in the outcome of the litigation. In June 2016, District Judge Richard Seeborg, chairman of the court's rules committee, proposed a revision to insert three words into the rule: "including litigation funders." These three words could possibly change the landscape of mass litigation by making California less attractive and by creating pressure to amend the Federal Rules of Civil Procedure to

include a disclosure requirement for third-party funding.

Because Civil Local Rule 3-15 imposes a duty to supplement, the proposed change could have an immediate effect on existing multidistrict litigation in California. The rules committee made public four comments submitted in response to the proposed amendment. Two litigation funders submitted comments opposing the amendment, arguing that the amendment would be unfair and discriminatory. In its letter to the rules committee, Burford Capital stated that the company was “publicly listed on the London Stock Exchange with a market capitalization of more than \$1 billion” and estimated that single-case funding amounted to approximately “15 [percent] of its investment activity last year.”⁵ In Bentham IMF’s response to the rule change, the litigation investment firm argued that “[c]ommercial litigation funding assists claimants with strong cases to achieve fair outcomes by removing the financial imbalance between parties.”⁶ Bentham IMF argued that requiring the automatic disclosure of third-party financing “will give defendants in all cases the unprecedented and unintended advantage of knowing which claimants lack the resources to weather a lengthy litigation campaign.”⁷

While Bentham might be correct that disclosure will provide information of potential benefit, *defendants* have long been required to disclose the presence of insurers and insurance policies during the discovery process — information that provides plaintiffs with the “advantage” of knowing which defendants lack insurance resources to “weather a lengthy litigation campaign.” The disclosure of third-party litigation funding merely evens the playing field with regard to information about the parties who have financial interests and who may affect the course of the litigation.

Regardless of whether third-party financing is here to stay, disclosures are warranted. Courts should have visibility into these otherwise hidden entities who have an interest in cases pending before them.

Endnotes

¹ Binyamin Appelbaum, “Investors Put Money on Lawsuits to Get Payouts,” *The New York Times* (Nov. 14, 2010), https://www.nytimes.com/2010/11/15/business/15lawsuit.html?pagewanted=all&_r=0.

² *WFIC, LLC v. Labarre*, 2016 WL 4769436 (Pa. Super. Sept. 13, 2016).

³ Ben Hancock, “Litigation Funder Plans Bay Area Expansion,” *The Recorder* (Oct. 27, 2016), <https://www.therecorder.com/id=1202770946023/Litigation-Funder-Plans-Bay-Area-Expansion>.

⁴ *Gbarabe v. Chevron Corp.*, No. 14-cv-00173-SI, 2016 U.S. Dist. LEXIS 103594 (N.D. Cal. Aug. 5, 2016).

⁵ Letter from Christopher P. Bogart, Chief Executive Officer of Burford Capital, to Susan Y. Soong, Clerk of Court, U.S. District Court for the Northern District of California (July 22, 2016), *available at* <https://www.cand.uscourts.gov/news/23>.

⁶ Letter from Matthew D. Harrison, Investment Manager/Legal Counsel, Bentham IMF, to Susan Y. Soong, Clerk of Court, U.S. District Court for the Northern District of California (July 22, 2016), *available at* <https://www.cand.uscourts.gov/news/23>.

⁷ *Id.*

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