(AGENDA BOOK)

ADVISORY COMMITTEE
ON
CIVIL RULES
Philadelphia, PA
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Excerpts of the November 7, 2017, Civil Rules Committee Meeting

substance-specific rules?

Judge Bates responded that neither the Administrative Conference nor the Social Security Administration have linked the procedure proposals to the remand rate. They are concerned with the inefficiencies of disparate procedures.

A Committee member asked whether it is possible to adopt national rules that will really establish uniformity. Local rules, standing orders, and individual case-management practices may get in the way.

A judge responded that one reason to have local rules arises from the lack of a national rule. The Northern District of Illinois has a new rule for serving the summons and complaint in these cases. "It's all about consent; the Social Security Administration consents all the time." But "local rules are antithetical to national uniformity." If national rules save time for the Social Security Administration, that will yield benefits for claimants and for the courts. Another judge emphasized that local rules must be consistent with the national rules, but it can be difficult to police. At the same time, still another judge noted that the Federal Judicial Center can educate judges in new rules. And a fourth judge observed that local culture makes a difference, but "some kind of uniformity helps."

Judge Bates concluded the discussion by stating that the Committee should explore these questions. A start has been made. The Subcommittee will be formally structured, and will look for possible rule provisions. We know that the Southern District of Indiana is working on a rule for service in disability review cases.

Third-Party Litigation Financing

Judge Bates introduced the discussion of disclosing third-party litigation financing agreements by noting that additional submissions have been received since the agenda materials were compiled. One of the new items is a letter from Representative Bob Goodlatte, Chair of the House Committee on the Judiciary.

The impetus for this topic comes from a proposal first advanced and discussed in 2014, and discussed again in 2016. Each time the Committee thought the question important, but determined that it should be carried forward without immediate action. The Committee had a sense that the use of third-party financing is growing, perhaps at a rapid rate, and that it remains difficult to learn as much as must be learned about the relationships between third-party financers and litigants. It is difficult to develop

comprehensive information about the actual terms of financing agreements. The questions have been renewed in a submission by the U.S. Chamber Institute for Legal Reform and 29 other organizations.

The specific proposal is 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.

Detailed responses have been submitted by firms engaged in providing third-party financing, and by two law professors who focused on the ethical concerns raised by the proponents of disclosure.

The first point made about the proposal is that it does not seek to regulate the practice or terms of third-party financing. It seeks nothing more than disclosure of any third-party financing agreement.

Many arguments are made by the proponents of disclosure. They are summarized in the agenda materials: "third-party funding transfers control from a party's attorney to the funder, augments costs and delay, interferes with proportional discovery, impedes prompt and reasonable settlements, entails violations of confidentiality and work-product protection, creates incentives for unethical conduct by counsel, deprives judges of information needed for recusal, and is a particular threat to adequate representation of a plaintiff class."

These arguments are countered in simple terms by the financers: None of them is sound. They do not reflect the realities of carefully restrained agreements that leave full control with counsel for the party who has obtained financing. In addition, it is argued that disclosure is actually desired in the hope of gaining strategic advantage, and in a quest for isolated instances of overreaching that may be used to support a campaign for substantive reform.

The questions raised by the proposal were elaborated briefly in several dimensions.

The first question is the familiar drafting question. How would a rule define the arrangements that must be disclosed? Inevitably, a first draft proposal suggests possible difficulties. The language would reach full or partial assignment of a

plaintiff's claim, a circumstance different from the general focus of the proposal. It also might reach subrogation interests, such as the rights of medical-care insurers to recover amounts paid as benefits to the plaintiff. It rather clearly reaches loans from family or friends. So too, it reaches both agreements made directly with a party and agreements that involve an attorney or law firm.

Parts of the submissions invoke traditional concepts of champerty, maintenance, and barratry. It remains unclear how far these concepts persist in state law, and whether there is any relevant federal law. There may be little guidance to be found in those concepts in deciding whether disclosure is an important shield against unlawful arrangements.

Proponents of disclosure make much of the analogy to Rule 26(a)(1)(A)(iv), which mandates initial disclosure of "any insurance agreement under which an insurance business may be liable" to satisfy or indemnify for a judgment. This disclosure began with a 1970 amendment that resolved disagreements about discovery. The amendment opted in favor of discovery, recognizing that insurance coverage is seldom within the scope of discovery of matters relevant to any party's claims or defenses but finding discovery important to support realistic decisions about conducting a litigation and about settlement. It was transformed to initial disclosure in 1993. At bottom, it rests on a judgment that liability insurance has become an essential foundation for a large share of tort law and litigation, and that disclosure will lead to fairer outcomes by rebalancing the opportunities for strategic advantage. The question raised by the analogy is whether the same balancing of strategic advantage is appropriate for third-party financing, not only as to the fact that there is financing but also as to the precise terms of the financing agreement.

Much of the debate has focused on control of litigation in general, and on settlement in particular. The general concern is that third-party financing shifts control from the party's attorney to the financer. Financers and their supporters respond that they are careful to protect the lawyer's obligation to represent the client without any conflict of interest. Indeed, they urge, their expert knowledge leads many funding clients to seek advice about litigation strategy, and to seek funding to enjoy this advantage.

The concern with influence on settlement is a variation on the control theme. The fear is that litigation finance firms will influence settlements in various directions. At times the pressure may be to accept an early settlement offer that is unreasonably inadequate from the litigant's perspective, but that ensures a safe and satisfactory return for the lender. An alternative concern is that at other times a lender will exert pressure to reject an early

and reasonable settlement offer in hopes that, under the terms of the agreement, it will win more from a higher settlement or at trial. Funders respond that it is in their interest to encourage plaintiffs to accept reasonable settlement offers. They avoid terms that encourage a plaintiff to take an unreasonable position.

Professional responsibility issues are raised in addition to those presented by the concerns over shifting control and impacts on settlement. Third-party financing is said to engender conflicts of interest for the attorney, and to impair the duty of vigorous representation. Special concern is expressed about the adequacy of representation provided by a class plaintiff who depends on third-party financing. Fee splitting also is advanced as an issue.

A different concern is that a judge who does not know about third-party funding is deprived of information that may be necessary for recusal. A response is that judges do not invest in litigation-funding firms, and that it reaches too far to be concerned that a family member or friend may be involved with an unknown firm that finances a case before the judge. In any event, this concern can be met, if need be, by requiring disclosure of the financer's identity without disclosing the terms of the agreement.

Yet another concern is that the exchanges of information required to arrange funding inevitably lead counsel to surrender the obligation of confidentiality and the protection of work product.

Disclosure also is challenged on the ground that it may interfere with application of the rules governing proportionality in discovery. Rule 26(b)(1) looks to the parties' resources as one factor in calculating proportionality. The concern is that a judge who knows of third-party financing may look to the financing as a resource that justifies more extensive and costly discovery, and even may be inclined to disregard the terms of the financing agreement by assuming there is a source of unlimited financing.

Finally, it is urged that third-party financing will encourage frivolous litigation. The financers respond that they have no interest in funding frivolous litigation — their success depends on financing strong claims.

All of these arguments look toward the potential baneful effects of third-party financing and the reasons for discounting the risks.

There is a more positive dimension to third-party funding. Litigation is expensive. It can be risky. Parties with viable claims often are deterred from litigation by the cost and risk.

Important rights go without redress. Third-party financing serves both immediate private interests and more general public interests by enabling enforcement of the law. It should be welcomed and embraced, no matter that defendants would prefer that plaintiffs' rights not be enforced.

The abstract arguments have not yet come to focus, clearly or often, on the connection between disclosing third-party financing agreements and amelioration of the asserted ill effects that it would foster. One explicit argument has been made as to settlement — a court aware of the terms of a financing agreement can structure a settlement procedure that offsets the risks of undue influence. More generally, a recent submission has suggested that "if a party is being sued pursuant to an illegal (champertous) funding arrangement, it should be able to challenge such an agreement under the applicable state law — and certainly should have the right to obtain such information at the outset of the case." This argument relies on an assumption of illegality that may not be supported in many states (some states have undertaken direct regulation of third-party financing), and leaves uncertainty as to the consequences of any illegality on the conduct and fate of the litigation.

Professor Marcus suggested that it is important to recognize that proponents of disclosure may have "collateral motives." He noted that third-party financing takes many forms, and that the forms probably will evolve. Financing may come to be available to defendants: how should a rule reach that? More specific points of focus should be considered. Rule 7.1 could be broadened to add third-party financers to the mandatory disclosure statement. Rule 23(g)(1)(A)(iv) already requires the court to consider the resources that counsel will commit to representing a proposed class; it could be broadened to require disclosure of third-party funding. Third-party financing also might bear on determining fees for a class attorney under Rule 23(h).

Professor Marcus continued by observing that there may be a need to protect communications between funder and counsel for the funded client. And he asked whether the jury is to know about the existence, or even terms, of a funding arrangement?

The local rule in the Northern District of California was noted. It provides only for disclosure of the fact of funding, not the agreement, and it applies only to antitrust cases. Including patent cases was considered but rejected.

A judge suggested that third-party funding seems to be an issue primarily in patent litigation and in MDL proceedings.

Professor Coquillette offered several thoughts.

First, he observed that the common-law proscriptions of maintenance, barratry, and champerty have essentially disappeared. "We keep tripping over the ghosts and their chains." State regulation has displaced the ghosts, in part because these are politically charged issues.

Second, he urged that even coming close to regulating attorney conduct raises sensitive issues for the Civil Rules. The rules do approach attorney conduct in places, such as Rule 11 and regulation of discovery disputes. The prospect of getting into trouble is reflected in the decision to abandon a substantial amount of work that was put into developing draft Federal Rules of Attorney Conduct. That effort inspired sufficient enthusiasm that Senator Leahy introduced a bill to amend the Enabling Act to quell any doubts whether the Act authorizes adoption of such rules. But there was strong resistance from the states and from state bar organizations.

Third, Professor Coquillette noted that third-party funders argue that the relationships are between a lay lender and a lay litigant-borrower. The lawyer, they say, is not involved. "I do not believe that lawyers are not involved." Lawyers are involved on both sides, dealing with each other. "There are major ethical issues." These issues are the focus of state regulation. Here, as before, the Committee should anticipate that proposals for federal regulation will meet substantial resistance from the states.

A Committee member identified a different concern about conflicts of interest. Often she is confident that there is funding on the other side. The risk is that her firm has a conflict of interest because of some involvement with the lender. She also noted that she believes that some judges have standing orders on disclosure. A judge agreed that there are some. Patrick Tighe, the Rules Committee Law Clerk, stated that many courts have local rules that supplement Rule 7.1 by requiring identification of anyone who has a financial interest in an action. But it is not clear whether these rules are interpreted to include third-party financing.

A Committee member stated that he has worked with third-party financing in virtually every patent case he has had in the last five years. He is not confident, however, that his experiences and the agreements involved are representative of the general field.

His first observation was that disclosure of insurance is unlike the general scope of discovery in Rule 26(b)(1). There are reasons to question whether disclosure of third-party funding should be treated as a phenomenon so much like insurance as to

require disclosure. "We need to know exactly what we're dealing with." Third-party funding creates risks, including ethical risks. The duty of loyalty may be affected. The lawyer still must let the client make the decision whether to settle, but third-party financing may generate pressures that make settlement advice more complex. Disclosure, of itself, will not bear on these problems. Many steps must be taken from the disclosure to make any difference.

"Warring camps" are involved. The proponents of disclosure have strategic interests. They would like to outlaw third-party financing because it enables litigation that would not otherwise occur. There is no question that funding enables lawsuits. Many of them are meritorious, though perhaps not all. In present practice, defendants seek discovery about financing. Objections are made. The law will evolve, and may come to allow routine discovery. There are settings in which funding can become relevant, as in the class-action context noted earlier. There may be guidance in decisional law now, but "I'm not aware of it."

Another Committee member responded that case law is emerging. Financing agreements are listed on privilege logs. Motions are made for in camera review. State decisions deal with work-product protection for communications dealing with third-party financing. Something depends on how the agreement is structured. Some courts say third-party funding is not relevant. For that matter, how about disclosure of contingent-fee arrangements? The Committee has never looked at that. Disclosure of third-party funding is increasingly required in arbitration, because of concerns about conflicts of interest, and also because of concerns that a party who depends on third-party financing may not have the resources required to satisfy an award of costs.

The Committee member who described experiences with third-party funding suggested that disclosure of the existence of funding may be less problematic than disclosing the terms of the agreement.

A Committee member suggested that ethics issues "are not our job." At the same time, it seems likely that there will be an increase in local rules.

A judge suggested that care should be taken in attempting to define the types of agreements that must be disclosed. A variety of forms of financing may be involved in civil rights litigation, in citizen group litigation, and the like. One example is litigation challenging election campaign contributions and activities. "We need to think about the impact." Another judge suggested that in state-court litigation it is common to encounter filing fees borrowed from family members, and many similar instances of

friendly financing, with explicit or implicit understandings that repayment will depend on success.

A third judge suggested that it would be useful to know about financing in appointing lead counsel, and also in settlement. He can "ask and order" to get the information when it seems desirable.

These questions about defining the kinds of arrangements to be disclosed prompted a suggestion that some help might be found in the analogy to insurance disclosure, which covers only an insurance agreement with an insurance business. Other forms of indemnity agreements, and business or personal assets, are not included. Although further refinement would be needed, it might help to start by thinking about disclosure, more or less extensive, of financing agreements with enterprises that engage in the business of investing in litigation.

A judge said that he had encountered various forms of funding arrangements on the defense side. Others who are interested in the outcome, directly or precedentially, may help fund the defense. Joint defense agreements often address cost sharing, and contributions may be set by making rough calculations of likely proportional liability. The prospect of such arrangements, and perhaps investments by firms that now engage in funding plaintiffs, should be considered in shaping any disclosure proposal that might emerge.

The Committee member who has dealt with third-party funding in patent litigation responded to questions by noting that he has clients who can fund their own patent litigation. But patent cases have become increasingly costly. The cost increase is due in part to an increasing number of hurdles a plaintiff must surmount to get to verdict and then through the Federal Circuit. The pendulum has shifted in patent law, making it more difficult to get to trial. In the old days, his firms and others could pay the expenses. But "as costs rose, and risks, we became less willing to cover the expenses." Third-party financing is replacing law firms as the source of financing.

Professor Coquillette observed that "we need to learn more." If work goes forward, it will be important to learn what states are doing about third-party financing. The states are better equipped than the federal courts are to deal with ethical issues such as conflicts of interest and control.

A judge suggested that it may not be useful to require disclosure of information when the courts are not equipped to do anything with the information. An example is suggested by litigation in which a defendant, after a number of unfavorable

rulings, retained as additional counsel a law firm that included the judge's spouse. Rather than countenance this attempt at judge shopping, the chief judge ordered that the new firm could not play any role in the litigation. Something comparable might happen with third-party financing, without the opportunity for an analogous cancellation of the financing agreement. It does not seem likely that judges will invest in enterprises that engage in third-party financing, but there may be a risk, especially with networks of related interests. Judge Bates noted that similar concerns had emerged with filing amicus briefs on appeal.

Judge Bates summarized the discussion by suggesting that a sense of caution had been expressed. Further discussion might be resumed in the discussion of MDL proposals, one of which explicitly adopts the disclosure proposal that prompted this discussion.

Rules for MDL Proceedings

Judge Bates opened the discussion of the proposals for special Multidistrict Litigation Rules by suggesting that two of the proposals are essentially the same, while the third is distinctively different.

All three proposals agree that MDL proceedings present important issues. They account for a large percentage of all the individual cases on the federal court docket. The Civil Rules do not really address many of the issues encountered in managing an MDL proceeding. Proponents of new rules suggest that courts often simply ignore the Civil Rules in managing MDL proceedings. And Congress has shown an interest. H.R. 985, which has been passed in the House, includes several amendments of the MDL statute, 28 U.S.C. § 1407.

The major concerns focus on cases with large numbers of claimants. The perception is that many of the individual claimants have no claim at all, not even any connection with the events being litigated by the real claimants. The concern is that there is no effective means of screening out the fake claimants at an early stage in the litigation. Many alternative means of early screening are proposed. But it is not clear what differences may flow from early screening as compared to screening at the final stages of the litigation if the MDL leads to resolution on terms that dispose of the component actions. Apart from the several proposals for early screening, concerns also are expressed about pressures to participate in bellwether trials and about the need to expand the opportunities to appeal rulings by the MDL court.

Several different early screening proposals are advanced. Some of them interlock with others.