Proposed NJ Rule on Legal Finance Is a Solution in Search of a Problem

There is already a robust framework in place for courts and litigants to obtain evidence regarding legal finance arrangements. Mandatory disclosure of any legal finance arrangement will result in needless fishing expeditions with respect to those finance relationships.

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In April, the U.S. District Court for the District of New Jersey announced an unprecedented, proposed amendment to its local civil rules that (1) would require all parties to a lawsuit to identify any non-recourse third-party financing, including a description of the interest and details of the agreement, and (2) purports to provide grounds for disclosure of “the terms of any [financing] agreement.”

The proposed amendment would be added to local rule 7.1, the rule that requires disclosures to help judges make recusal and disqualification decisions. As the Code of Conduct for United States Judges notes, the corresponding rule applicable in all federal courts (FRCP 7.1) mandates very few disclosures for this purpose, in part because “[u]nnecessary disclosure requirements place a burden on the parties and courts.” That is very much the case with this proposal, and is particularly relevant to the District of New Jersey, which boasts the highest weighted caseload per judgeship and is currently in a state of “judicial emergency.”

Other federal courts and rule-making bodies have rejected calls for mandating disclosure of legal finance arrangements. While certain district courts maintain local rules supplementing FRCP 7.1, they do so for the stated purpose of judicial conflicts, apply generally to various types of financial interests, and do not provide grounds for additional disclosure. Here, however, the proposed local rule appears to have other motivations, specifically targets non-recourse financing, and invites further discovery.

The lack of transparency in this rulemaking process makes it difficult to know what caused such a radical departure from widely accepted norms regarding disclosure. It is clear, though, that the proposal has several manifest problems. For example, it is ambiguous in many respects, failing to define key terms in a manner that would render compliance difficult, ignores the realities of how legal finance arrangements are structured, and even leads to the presumably unintended requirement that contingency fee agreements be disclosed. (Engagement agreements are not typically considered relevant absent special circumstances, and they have certainly never been the subject of mandatory disclosure, even where attorneys are responsible for funding disbursements.) Perhaps more importantly, it will lead to the promotion of unnecessary and unfounded motion practice, increasing the cost and expense of litigation, including judicial resources.

The Proposed Rule Compounds the Very Problems That It Seeks to Solve

Proponents of a mandatory disclosure rule often seek to justify the need for such a rule by arguing that it will promote "transparency" in the litigation process. But the word "transparency" as a goal unto itself and divorced from any analysis under applicable procedural and discovery rules is a recipe for mischief.

There is already a robust framework in place for courts and litigants to obtain evidence regarding legal finance arrangements. These arrangements have always been and remain subject to the rules of discovery like any other factual matter at issue in a case. Under FRCP 26(b)(1), parties can obtain discovery of a nonprivileged matter that is "relevant to any party's claim or defense and proportional to the needs of the case, considering," among other things, "whether the burden or expense of the proposed discovery outweighs its likely benefit." Federal courts have issued dozens of opinions analyzing the disclosure of legal finance evidence under Rule 26(b)(1), leading to a well-developed body of law holding that disclosure is unwarranted absent special circumstances.

Indeed, courts possess inherent authority to order the disclosure of such materials (or any other material) where appropriate. For example, in several multidistrict litigations, including the national prescription opioid litigation, courts have issued disclosure orders regarding legal finance arrangements in a manner that was highly tailored, promoted judicial economy, respected Rule 26's relevance requirement, and, importantly, considered the specific requirements of those cases.

The proposal ignores the above precedent and, in so doing, fails to recognize a basic truism regarding the litigation process. Absent strict rules curtailing the practice, litigants will pursue every avenue available to them to gain a strategic advantage—and this only increases as the stakes of the litigation rise. Thus, mandatory disclosure of any legal finance arrangement will result in needless fishing expeditions with respect to those finance relationships. Courts will have their dockets clogged with dilatory motion practice and litigants will spend more money pursuing and defending against such motions, thereby injecting increased delay and expense into the litigation process.

The potential for discovery abuse is not hypothetical. While cloaked in a desire for "transparency," motions to compel regarding legal finance are motivated by the pursuit of prejudicial information. Movants regularly seek party and third-party discovery ranging from funding agreements to litigation budgets, to communications with funders and potential funders that discuss case strengths and weaknesses. *See* comments from International Legal Finance Association, May 21, 2021, n.42.

Anticipating this very risk, the disclosure order in the opioid litigation created an ex parte, in camera mechanism for the review of financing arrangements and expressly stated that "absent extraordinary circumstances, the Court will not allow discovery into [financing]." Here, the proposed rule unfortunately takes the opposite approach. It fails to provide any protections around an irrelevant topic while encouraging parties to seek discovery of financing agreements where "good cause" is shown. This is not only a recipe for fishing expeditions, but also an improper abrogation of work-product protection routinely given to financing agreements that may only be pierced under Rule 26(b)(3) based on a special showing of "substantial need."

One New Jersey multidistrict case illustrates these points. In *In re: Valsartan N-Nitrosodimethylamine (NDMA) Contamination Prods. Liability Litig.*, the court issued a 19-page opinion "agree[ing] with the plethora of authority that holds that discovery directed to a plaintiff's litigation funding is irrelevant." *See* 405 F.Supp.3d 612, 615 (2019). While stopping short of finding that "litigation funding discovery is off-limits in all circumstances," the court held that "rather than directing *carte-blanche* discovery of plaintiffs' litigation funding," it would order discovery "only if good cause exists to show the discovery is relevant to the claims and defenses in the case."

We understand that the DNJ Lawyers' Advisory Committee had the *Valsartan* case in mind when it proposed its new rule, based on a belief that it would foster "consistency" and "benefit the public, the bench, and the bar." It is true that the proposed rule would lead to consistent disclosure of the existence and details of legal finance arrangements. However, that disclosure is unlikely to satisfy the opponents' desire for discovery; instead, it will only serve as a starting point. To that end, the *Valsartan* movants sought much more than would have been disclosed under the proposed rule. They wanted to explore, among other side issues, "the real party in interest," "plaintiffs' credibility and bias," and "the scope of potential sanctions." Even if the proposed rule had been in effect at the time of the *Valsartan* decision, the same motion to compel would have been necessary, and the court still would have been obliged to conduct a case-specific analysis pursuant to Rule 26's relevance and proportionality requirements.

By requiring disclosure in every case and opening the door to "other disclosure" that is "necessary to any issue in the case," the proposed rule would encourage parties to make similar motions that waste judicial resources and divert focus from material issues.

The Proposal Deviates from the Consensus Approach, Without Explanation

Putting aside the fact that the proposed rule ignores the inefficiencies and inequities that will inevitably arise should it pass, it also ignores countless studies and analyses on this very issue that have rejected this precise rule change, whether as an amendment to Rule 7.1 or any other authority, including:

- 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, and 2019, the U.S. Chamber Institute for Legal Reform lobbied the Civil Rules Advisory Committee to force disclosure of financing arrangements in all civil cases, making the very same arguments it again repeated in its comment on the proposed local rule. *See* https://instituteforlegalreform.com/us-chamber-njcji-comments/. After multiple in-depth studies on litigation financing, the proposed rule change has been rejected every time.

- Attempts to pass federal legislation to require disclosure before the Senate Judiciary Committee have likewise failed. The Litigation Funding Transparency Acts of 2018 and 2019 would have required the disclosure of funders and financing agreements in class actions and multidistrict litigation. Neither progressed after referral to the Senate Judiciary Committee.

- In 2019, the New York City Bar Association formed a working group to study litigation financing. The working group published a report in February 2020, concluding that it "does not at this time support any mandatory disclosure requirement with respect to the funding of commercial litigation" or "discoverability of the details of funding arrangements absent special circumstances."

- The Uniform Law Commission has twice formed committees on litigation financing and declined to propose uniform state legislation on both occasions. The ULC noted in July 2020 that "the topic remains highly politically charged" and "the committee did not receive reports of a lack of uniformity [concerning third-party litigation funding] causing any problems."

The weight of this consensus makes it even more important for the DNJ Lawyers' Advisory Committee to share the study—which, to our knowledge, did not include input from a single commercial legal financier—that led to its contrary approach. At minimum, the study should be released in the interests of transparency so the public can evaluate the grounds for imposing requirements that so many others have deemed inappropriate.

Current law allows for disclosure where appropriate. The District of New Jersey proposal adds nothing of value to the existing framework. Neutral parties nationwide have already spoken, and while we respect the District of New Jersey's voice on this issue, it has truly created a solution for which there is no problem.

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