MEMORANDUM

To: Texas Supreme Court Advisory Committee

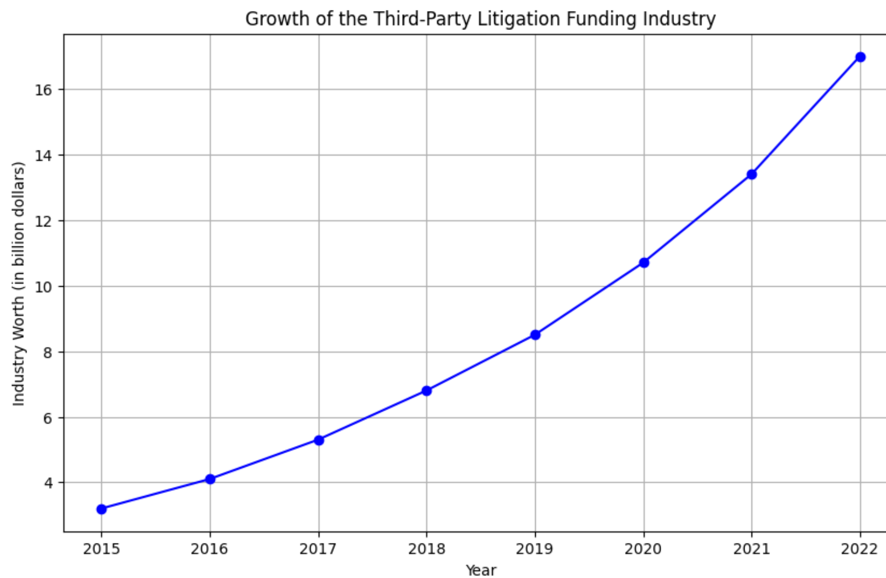
From: Robert Levy[1]

Re: The Case for TPLF Disclosure

Date: October 31, 2024

I. In a Short Period of Time, Funding has become a Major Factor in Civil Litigation

The relatively recent trend of third party investment in the outcomes of civil litigation (commonly referred to as Third Party Litigation Finance (or Funding) – TPLF) is growing exponentially in the U.S. following the first indications of the involvement of funding firms approximately 15 years ago.[2] The following graph demonstrates the explosive growth from 2015 to 2022:



While funding currently represents a relatively small segment of the civil litigation economic ecosystem, the rapid growth of the funding industry indicates that third party funding will soon play a role in a significant percentage of civil litigation actions in Texas state and federal courts.

Funding is already reshaping our civil litigation system and disclosure is critical to the understanding of the consequences in individual cases and in our litigation system. Professor Maya Steinetz, Professor of Law and R. Gordon Bulter Scholar at Boston University School of Law is one of the nation's leading experts on TPLF. She has written numerous Law Review articles on the topic and has testified multiple times before Congress (and is cited in John Kim's

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[1] Please note that this memo is submitted solely in my personal capacity.

[2] Burford Capital, one of the funder industry leaders celebrates its 15 year anniversary on its website: Burford Capital | The Gold Standard In Legal Finance.

memo). In a recent draft article[3], Professor Steinetz makes the following statement regarding the need for disclosure due to the profound impact funding is having and will have on our legal system.

> 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.'[4]

Currently, the involvement of funding in litigation is largely obscured because funders have historically resisted any efforts to require disclosure.[5] The impact of funding in these cases is a critical reason why many companies and entities have urged the Texas Supreme Court to adopt rules requiring the disclosure of the existence of funding in cases as well as the disclosure of the terms of agreements entered into between funders, the parties and their attorneys.

II. The SCAC and Texas Supreme Court Should Not Wait on Federal Action

As my learned friend and colleague John Kim notes in his memo to the SCAC, the issue of TPLF disclosure is being evaluated by the Federal Civil Rules Advisory Committee as well as the subject of proposed legislation filed in the current Congress. John observes that the fact that prior efforts to push for disclosure have failed 'for good reason' suggests that the SCAC should wait before acting to see if federal legislation or rules amendments are adopted. The rules suggestion for TPLF disclosure was submitted to the Federal Civil Rules Advisory Committee in April, 2014. The Federal Judges who were members of the committee at that time stated they had no idea about the existence of funding and that the issue had never been raised in their courts (I attended Advisory Committee meetings where the topic was discussed). In the intervening years, however, funding has now become pervasive and one of the current members of the Federal Civil Rules Advisory Committee noted at its recent meeting that he estimates that funding is involved in 50% of his IP cases.

Waiting for Congress to act is not well advised – there are legions of stakeholders on innumerable issues of import who are aging in place while they await Congressional action. Additionally, while our Committee has often found guidance in the rule amendments adopted by

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[3] See M. Steinitz, *Zombie Litigation: Claim Aggregation, Litigant Autonomy and Funders' Intermeddling*, September 2024

[4] *Id.*

[5] Only recently have some funders and the ILFA tempered their position, implying that they have no problem with 'reasonable' disclosure requirements yet fiercely resisting the disclosure of the agreements themselves that detail how funders have the ability to influence the litigation. See the August 30, 2024, from Kent Hance to Judge Harvey Brown.

the Federal Judiciary, we understand that we are well capable of acting without following in their footsteps. This is particularly true due to the extraordinarily long process involved in amending federal rules. In this case, an amendment to the Federal Rules of Civil Procedure on TPLF disclosure in the fastest possible scenario would not take effect until December of 2029.

III. TPLF is a Very New and Different Dynamic

Those supporting funding and opposing disclosure often suggest that third party funding is nothing new or different from hundreds of years of precedent where parties to litigation or law firms have obtaining loans or other financial assistance to enable them to pursue their rights in court. As John Kim notes, this can include funding from friends, neighbors or banks. However, TPLF however is an entirely different phenomenon; unlike bank loans, third party funding is the commoditizing of our civil litigation system, resulting in funders essentially taking educated bets on the outcome of litigation. Banks and other traditional lenders generally expect repayment, even if the borrower does not prevail in the litigation.

The funders however have an entirely different model, they do not seek any repayment of the loan, they simply seek a percentage of the potential return. They are not interested in social justice or providing relief to those who have been injured – the funders are only looking to make money from the litigation. The model is very different from situations where banks loan funds to a party or to attorneys with the expectation of repayment with interest. In the case of TPLF, the funders get nothing if the case fails but that is more than offset by the potential for incredibly lucrative returns if the plaintiff receives a large judgement. Funders know that they can lose in 9 out of 10 of the cases they fund if they can hit it big in the 10th case.

IV. TPLF Disclosure is Not An Access to Justice Issue

Litigation funding is not an access to justice issue. There is no evidence that without the existence of TPLF, parties would be unable to pursue litigation to protect their rights. Additionally, the case for disclosure would not threaten the ability of individuals and companies to use funding to gain access to the courts. Funding would be unimpaired if disclosure is required. Moreover, the traditional financial arrangements noted by John Kim as well as contingency fee agreements between lawyers and their clients provide significant opportunities for parties to access the legal system.

I agree that the costs of litigation is a barrier to access and can result in the inability of parties to utilize our civil justice system to resolve disputes. This is a major issue that impacts both plaintiffs with meritorious claims as well as defendants with strong defenses. Too often a defendant has to settle a case when it has a clear path to prevail simply because the costs of following that pathway are so high to make continuing the case unviable. However, situations where otherwise non-meritorious cases are brought as speculative investments through funding sponsorships also creates a barrier to the application of justice. Finding opportunities to make the adjudication of the rights of the litigants just, fair, equitable and impartial for all the participants should be the core goal. (Texas Rule of Civil Procedure 1)

Importantly, unlike the parties and attorneys involved in the case, currently funders are not subject to any ethical duties or rules that govern disclosure or transparency in the proceeding.

Unlike ethical rules pertaining to contingency fee agreements, funders are unfettered in their ability to enter into agreements and impact the outcome of litigation. Moreover, some courts have required TPLF disclosure precisely so that funders could be held responsible for any sanctions or costs that are imposed during discovery.

Funding interests clearly impacts the course of a litigation proceeding; it changes the dynamics and incentives of the parties and their attorneys. For the same reason that plaintiffs want access to insurance policies, defendants want access to funding agreements. The fact of insurance, while irrelevant to the merits of the case, is important information relative to a number of factors, including whether the case can settle. The existence of insurance coverage does not give the plaintiff any rights in the underlying case and the topic of coverage and the amount is not admissible to a jury due to the likelihood of severe prejudice. However, the plaintiff wants this information because it gives critical information to understand whether the case can settle.

Suggesting that disclosure of TPLF agreements should be considered equivalent to the disclosure of how defendants fund their defense is inapposite. If a funder of a defendant has an interest in the outcome of the litigation (for example through a counterclaim), that agreement would be subject to disclosure. The fact of how a defendant funds its defense is no different than the fact of how a plaintiff funds its case – <u>except when the plaintiff or firm conveys an interest in the outcome of the case.</u>

V. <u>TPLF Agreement Disclosure is Needed to Understand How Funders Control the Litigation</u>

Those speaking on behalf of the funding industry, including John Kim and the International Legal Funding Association, suggest that funders benefit our legal system, enabling broad access to courts. (Alternatively, funders suggest that at worst funders are just like other lenders and they have a benign impact on the course of litigation.) Funders ferociously resist disclosure of the terms of their agreements even while they loudly proclaim that they never include terms in agreements giving them control over whether a case settles.

The problem, of course, with this broad statement of the lack of *de jure* control language, is that without transparency, it is impossible to test this assertion. However, in some of the funding cases that have been the subject of litigation, funders have had control rights. It is also understood that the methodology of how funders set up their involvement in cases ensures that they have at the very least a major say in how the case is managed and, in many cases, de facto control due to their very real power of the purse.

As was noted in a recent panel discussion at NYU Law School, a funder from Parabellum Capital noted that funders obviously want to fund in tranches to ensure that their interests are protected. It would make little sense for a funder to give the full amount of the commitment to the plaintiff up front, instead the funder typically gives the money throughout the course of the litigation based on agreed-to criteria. This of course gives the funder substantial leverage and influence on how the litigation proceeds. If the funder is unhappy that the plaintiff rejected a settlement offer, the funder can simply decide to withhold future funding, forcing the plaintiff to reconsider. It may be argued that the funding agreements do not give the funders discretion to withhold distributions, but again this is not a fact that can be ascertained without disclosure.

The issue of control and the emerging impact it is having in litigation is described in a forthcoming law review article by another leading scholar in the study of funding and its impact

on litigation[6], Professor Samir Parikh, Professor of Law, Wake Forest University School of Law. Professor Parikh makes the following observation regarding the funding world and its players:

> Most mass-tort financiers are principled actors, content to passively invest in cases and allow claimants and their attorneys to guide outcomes. But hidden among this group is a divergent breed: private equity firms and multistrategy hedge funds that I have termed "opaque capital." A new apex predator has entered the mass-tort ecosystem, and its tactics have been obscured by its ability to strike from the shadows. These puppeteers will never be passive investors. Opaque capital is moving into mass torts to dictate outcomes.
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> Opaque capital's unique brand of chaos is manifested most clearly at two distinct points. Primarily, opaque capital has the means to orchestrate the claim marshalling process in order to build—and in some cases create—a lucrative case. This idea provides the foundational premise for my theory, the Alchemist's Inversion. Many claims in a mass-tort dispute are nonmeritorious. If litigated, there is a high probability that these claims would be rejected by the judicial system. Opaque capital understands, however, that if these claims are bundled with meritorious ones, the resulting critical mass could force a defendant to pay a premium to settle all claims. The Alchemist's Inversion describes a litigation financier's use of unethical and potentially illegal tactics to create, enhance, and marshal apparently low-value claims with the hope of turning them into gold.
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> The corollary to the Alchemist's Inversion is that opaque capital must control when cases settle to maximize the value of the asset it has created. In order to do so, opaque capital is (i) exerting contractual control through the capital provision agreement it signs with plaintiffs' law firms and claimants, and (ii) relying on relational leverage to persuade key actors to remain compliant at seminal moments.

VI. TPLF Agreements Are Not De facto Subject to the Work Product Doctrine

Funders (and John Kim) understandably contend that their funding agreements constitute attorney work product, and some courts have concluded that TPLF agreements are covered by the work product doctrine. However, at its core, similar to the terms of an insurance policy, the fundamental economics of a case describing the interests of the funders in the outcome should not be considered work product. Additionally, the question of whether a funding agreement is work product, and whether the exceptions to the application of the work product doctrine that would warrant disclosure of the work product based on substantial are issues that should be addressed by the trial court.

Further, suggesting that funding agreements by their nature are work product because they incorporate litigation strategy essentially invites funders to simply add clauses in their funding agreements that reference litigation strategy issues. Fundamentally, it is problematic for a non-party to the case that has no involvement in the litigation (at least not transparently) is entitled to shield their contractual agreements under the work product doctrine.

[6] S. Parikh, *The Alchemist's Inversion*, 110 Cornell L Rev. _____ (forthcoming 2025)

Additionally, if a funding agreement does have sections that are determined to be work product, those provisions can be redacted when produced. Funders should not be entitled to a categorical finding that all their agreements are work product.

VII. The Advisory Committee Should Recommend a Disclosure Rule

Disclosure of TPLF is needed due to enable courts and parties to address key issues in the course of Texas litigation, including:

- Understanding the resources of the parties to make determinations of whether discovery is unduly burdensome or otherwise disproportionate.
- Determination of decision makers to assess
- Enable judges to determine adequacy of representation, particularly in cases involving class actions or *ad litems*.
- Assessing the credibility of witnesses under the Texas Rules of Evidence, including whether witnesses have a direct or indirect interest in the outcome of the case.
- Whether judges would be required to recuse if they have a financial interest in the matter or the appearance of one. This could include interests in funding companies or other entities that could benefit from the outcome of the case. As funding grows exponentially in scope, this will become a bigger issue.
- 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. 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.

I encourage the SCAC to amend Rule Texas Rule of Civil Procedure 194 to include the disclosure of funding and funding agreements.

Thank you for the opportunity to express my thoughts.