RULES SUGGESTION
to the
ADVISORY COMMITTEE ON APPELLATE RULES

PERVASIVE, YET UNKNOWN: THE PREVALENCE OF DIRECT, UNDISCLOSED NON-PARTY FINANCIAL STAKES IN APPELLATE OUTCOMES, AND WHY THE COMMITTEE SHOULD AMEND RULE 26.1

September 1, 2022

Lawyers for Civil Justice ("LCJ")[1] respectfully submits this Rule Suggestion to the Advisory Committee on Appellate Rules ("Committee").

Introduction

Direct, yet undisclosed non-party financial stakes in appellate outcomes are pervasive in federal circuit courts. These concrete rights—typically, a right to receive a percentage of proceeds contingent on the court's decision to uphold a judgment—arise from litigation funding contracts and popular "crowdfunding" web sites. Such rights can be held by individuals, investment funds (including family offices), and institutions, both domestic and non-US. Unfortunately, circuit judges are largely unaware that such non-party interests are present in the cases they decide. Rule 26.1 of the Federal Rule of Appellate Procedure does not require disclosure of these financial arrangements and therefore does not assist judges in determining whether they pose potential conflicts of interest or create the appearance of impropriety. Local rules do not do so either; although six of the twelve circuit local disclosure rules are broad enough to include such rights, none of them specifically mentions non-party rights created by funding contracts—an oversight that litigation funders rely upon to conclude that those rules do not apply to their financial stakes. Closing this disclosure gap would be consistent with the Chief Justice's recent call for "greater attention to promoting a culture of compliance" in the federal judiciary,[2] which

[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] 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.

was inspired by the *Wall Street Journal*'s reporting of 685 instances of conflicts of interest.[3] Amending Rule 26.1 to cover non-party outcome-contingent rights to share in the proceeds of litigation matters is necessary to provide judges adequate, uniform disclosures.[4]

I. Undisclosed Non-Party Financial Rights Are Commonplace in Appellate Cases

There are $11 billion worth of non-party financial rights in litigation outcomes in the United States today, according to a recent survey.[5] Such rights exist for litigation at all stages[6]—including appeals[7]—in all federal courts and in cases of a wide variety of subject matters. Appellate cases "seem[] to be a significant sub-category of litigation funding,"[8] according to the Advisory Committee on Civil Rules, which has been studying the matter since 2014. These financial rights are held by individuals, asset managers (including family offices), hedge funds, and institutions,[9] including both non-US individuals[10] and sovereign wealth funds.[11]

II. The Financial Rights Held by Non-Party Investors Are Directly Contingent on the Outcome of Appeals

The financial rights that non-party litigation investors receive in exchange for their investments are directly 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."[12] These are not loans. Litigation finance provider LexShares explains:

> Solutions are instead structured as non-recourse investments, which means that the funding recipient owes nothing if the lawsuit does not result in a recovery. If the case reaches a

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[3] *Id*. at 3.

[4] The Committee is separately devoting attention to considering whether to require more disclosures from amici curiae. The need for disclosure about non-party financial rights contingent on the outcome of an appeal is far more compelling. Non-parties with financial rights that are directly contingent in the outcome of an appeal are akin to real parties in interest, and are far different from ordinary members of an advocacy organization or trade association that publicly files an amicus brief, thus identifying their group as interested in the appeal. Litigation funds are completely unknown to the court.

[5] 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.").

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

[7] *See* Appeal Funding Partners, https://appealfundingpartners.com/.

[8] Advisory Committee on Civil Rules, Agenda Book, at 381 (Oct. 5, 2021).

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

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

[11] Burford 2021 Annual Report at 12.

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

> positive outcome, then the funding recipient would owe a predetermined portion of any damages recovered.[13]

Another large litigation financing firm, Burford, similarly explains:

> In return [for our investment], we receive our contractually agreed entitlement from the ultimate settlement or judgment on the claim and, if the claim does not produce any cash proceeds, we generally lose our capital.[14]

The nature of investors' financial rights is the same in appellate cases, as a firm specializing in appellate investments, Appeal Funding Partners, explains:

> An Appeal Funding cash advance is not a loan. It is an investment in a portion of a judgment on appeal. . . . In this regard, our goals and yours are perfectly aligned. *If you win, we win*. And you have the added security of knowing that if the case is eventually lost, you keep every dollar we advanced to you and you owe us nothing. If the case is ultimately won, we all win.[15]

Because the non-party financial entitlements that we are describing are directly dependent on the outcome of cases, and because there are no countervailing interests in nondisclosure of this information,[16] judges should know when they are present.

III. Circuit Judges Should Be Able to Determine Whether Financial Rights Contingent on the Outcome of Appeals Pose a Conflict of Interest

Circuit judges are required by statute,[17] the Code of Conduct for Federal Judges,[18] and the Judicial Conference Mandatory Conflict Screening Policy[19] to recuse themselves when they know that they have a financial interest that would be substantially affected by the outcome of the proceeding. This responsibility applies to financial interests "however small"[20] and extends to include any "appearance of impropriety."[21] Compliance with these provisions requires judges

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[13] *Id.*
[14] Burford 2021 Annual Report at 13.
[15] Appeal Funding Partners, Our Solutions, https://appealfundingpartners.com/our-solutions/ (emphasis added).
[16] By contrast to the funding at issue here, the U.S. Supreme Court has recognized the First Amendment prohibits "compelled disclosure of affiliation with groups engaged in advocacy" where the government has "no offsetting interest 'sufficient to justify the deterrent effect' of [such] disclosure." *See Ams. for Prosperity Found. v. Bonta*, 141 S. Ct. 2373, 2382 (2021) (citation omitted). It has counseled, "Protected association furthers 'a wide variety of political, social, economic, educational, religious, and cultural ends,' and 'is especially important in preserving political and cultural diversity and in shielding dissident expression from suppression by the majority. . . . [I]t is hardly a novel perception that compelled disclosure of affiliation with groups engaged in advocacy may constitute as effective a restraint on freedom of association as [other] forms of governmental action." *Id.* (citations omitted).
[17] 28 U.S.C. § 455.
[18] Code of Conduct for Federal Judges, Canon 3(C)(1)(c).
[19] U.S. Courts, Guide to Judiciary Policy, Mandatory Conflict Screening Policy, https://www.uscourts.gov/sites/default/files/guide-vol02c-ch04.pdf (last revised Mar. 15, 2022).
[20] Code of Conduct for Federal Judges, Canon 3(C)(3)(c).
[21] Code of Conduct for Federal Judges, Canon 2.

to be able to discover when non-party individuals, asset managers, and funds have contingent rights in proceeds triggered by the outcomes of appeals that they are handling.

IV. Rule 26.1 Should Be Amended to Provide Circuit Judges the Disclosures Necessary to Determine Whether Outcome-Contingent Non-Party Financial Entitlements Pose Conflicts of Interest

The purpose of Rule 26.1 is to "assist[] a judge in ascertaining whether or not the judge has an interest that should cause the judge to recuse himself or herself from the case," according to the 1998 Committee Notes.[22] But the Rule says nothing about potential non-party financial rights, even where those interests are directly affected by the outcome of the case. It merely requires that "[a]ny nongovernmental corporation that is a party to a proceeding in a court of appeals must file a statement that identifies any parent corporation and any publicly held corporation that owns 10% or more of its stock or states that there is no such corporation."[23] To assist circuit judges in obtaining the information required to ascertain whether any potential non-party financial rights exist in the case, the Rule should be amended to require disclosure of non-party financial rights that are directly contingent upon the outcome of the appeal. Such an amendment would be consistent with the current Rule's focus on interests that are concretely affected by the outcome of an appeal; as the 1998 Committee Notes explain, "disclosure of entities that would *not* be adversely affected by a decision in the case is unnecessary."[24]

V. Circuit Local Rules are Inconsistent, Unclear, and Not Specific Enough to Encompass the Commonplace Non-Party Financial Entitlements Held by Litigation Investors

The variation in circuits' local rules on this subject further highlights the case for amending Rule 26.1 to create a uniform rule requiring disclosure of non-party financial rights contingent on the outcome of appeals.[25] Six circuits generally require disclosure of "all persons" or "other legal entities" that "are financially interested in the outcome of the litigation."[26] But because those rules do not specifically mention rights created by litigation financing contracts, some holders of these entitlements interpret the rules not to apply. Burford explains:

> Six out of 12 federal circuit courts of appeal have local variations on Rule 26.1 that additionally require outside parties with a financial interest in the outcome to be disclosed. None of these rules, however, singles out litigation finance providers for disclosure . . . .[27]

The result is today's lack of disclosure of such arrangements. In Burford's words: "[T]hese broad disclosure provisions in local rules do not appear to be much-followed or enforced."[28]

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[22] Fed. R. App. P. 26.1 committee notes to 1998 amendment.
[23] Fed. R. App. P. 26.1(a).
[24] Fed. R. App. P. 26.1 committee notes to 1998 amendment.
[25] Memorandum 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), *in* Advisory Committee on Civil Rules, Agenda Book, at 209 (Apr. 10, 2018).
[26] *See, e.g.*, 5th Cir. R. 28.2.1.
[27] Burford Article.
[28] *Id.*

Accordingly, amending Rule 26.1 to provide an explicit, uniform[29] disclosure standard for non-party outcome-contingent financial entitlements—and specifically mentioning rights to settlement or judgment proceeds that stem from litigation investment arrangements—is necessary for judges to determine whether such rights pose a conflict of interest in their cases.

Conclusion

Rule 26.1 is failing to provide circuit judges any information about the non-party, outcome-contingent financial rights that are commonplace in appellate cases today. Because circuit judges are responsible for determining whether such interests pose a conflict of interest, Rule 26.1's omission hampers the Judicial Conference's goal of promoting a greater "culture of compliance" in the judiciary. The various local disclosure rules have not proven an adequate substitute. The Committee should thus amend Rule 26.1 to require disclosure of non-party outcome-contingent rights to settlement or judgment proceeds tied to the outcome of cases, specifically including such interests arising from litigation investment contracts.

[29] The 1989 Committee Notes to Rule 26.1 invited circuits to develop local disclosure rules, but stated: "However, the committee requests the courts to consider the desirability of uniformity and the burden that varying circuit rules creates on attorneys who practice in many circuits." Fed. R. App. P. 26.1 advisory committee notes (1989 addition).