Identifying Trends And Tips In Litigation Financing Disclosure

By **Sean Callagy and Samuel Sokolsky** (August 24, 2023)

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In recent years, an increasing number of courts have either required that parties disclose third parties with financial stakes in a litigation, or have allowed opposing parties to take discovery of third parties' financial stakes in the litigation.

This follows growing interest and controversy into litigation financing, where third parties typically pay for the expenses of the litigation in exchange for a financial stake in the outcome.

Litigation financing raises several salient concerns — for example, who the real-party-in-interest is, and if there is potential bias where witnesses have a financial stake in the outcome of the litigation.

We explore recent developments and trends for the compelled disclosure of litigation financing and what it means for practitioners.

We will look at jurisdictions that require litigants to disclose information about third-party financial interests, and leading reasons that litigants are granted further discovery: namely, for damages and valuations of patents, to assess witness bias, and for standing and real-party-in-interest questions.

Local Rules and Standing Orders

Some courts mandate by local rule the disclosure of parties with a financial interest in the litigation, typically for purposes of evaluating conflicts and potential grounds of recusal.[1]

Where parties fail to make adequate disclosures, courts have compelled this information upon a motion by the opposing party.[2] Therefore, if counsel has reason to believe their litigation adversary is not providing such mandated disclosures, counsel should be prepared to file a motion seeking relief.

Further, at least one judge has a standing order compelling detailed information on this topic to be disclosed to the court. Chief Judge Colm Connolly of the U.S. District Court for the District of Delaware requires disclosure of specific information relating to a third party "funding some or all of the party's attorney fees" in exchange for a financial interest in the litigation or some other nonmonetary result.[3]

The information to be disclosed includes the funder's name and information, a description of the financial interest taken, and whether third-party approval is necessary for litigation or settlement decisions.[4]

Further, the order allows for parties to seek additional discovery concerning the nature of the agreements for specified reasons as well as any other basis supported by good cause.[5]

Judge Connelly's requirements recently survived a mandamus challenge in the U.S. Court of Appeals for the Federal Circuit brought by a litigant seeking to avoid the mandated

disclosures in connection with contempt proceedings.[6]

In declining to grant mandamus, the Federal Circuit last year in In re: Nimitz Technologies LLC credited the four grounds of concern articulated by Judge Connolly as a basis to require the disclosures. Those grounds are:

- Whether counsel for the disclosing party complied with rules of professional conduct;
- Whether counsel had complied with the court's orders;
- Whether there were real-parties-in-interest whose identities were concealed from the court and opposing parties; and
- Whether such real-parties-in-interest had perpetrated a fraud on the court by fraudulent conveyances and fictitious filings with the U.S. Patent and Trademark Office to avoid future liability.[7]

The dangers of failing to comply with the local rules or a judge's standing order are exemplified in another still-developing case before Judge Connolly — Backertop Licensing LLC v. Canary Connect Inc. — where, despite the plaintiff dismissing the action, possibly to avoid having to disclose the required information, he set a "show cause" contempt hearing for the attorneys who refused to comply.[8]

Damages and Valuation of Patents

When discovery into litigation financing is contested, some courts begin with a baseline presumption that "litigation funding information is generally irrelevant to proving the claims and defenses in a case," according to the U.S. District Court for the Northern District of Illinois' 2019 ruling in Fulton v. Foley.[9]

However, courts have identified a first significant exception in recognizing that litigation financing arrangements can be potentially relevant to damages, such as where such materials directly bear upon a reasonable royalty rate or the valuation of a patent.[10]

For example, the U.S. District Court for the Western District of North Carolina recently found in Electrolysis Prevention Solutions LLC v. Daimler Truck North America LLC that litigation financing documents are discoverable to the extent that they show the value that the litigation financer put on a patent when determining if they should fund litigation, and that this valuation may be useful for calculating a reasonable royalty.[11]

However, when parties broadly assert a damages-based relevance ground without articulating how any litigation financing agreements would bear on this, courts have been more inclined to deny or curtail such discovery.[12]

Judge Leonard Stark, sitting as court-appointed special master in Cirba Inc. v. VMWare Inc. in the District of Delaware in 2021, noted the lack of consensus on discoverability of such materials, and found that the case law did not "explain why litigation financing documents are broadly relevant to damages."[13]

Judge Stark further noted that when the court "pressed [the party seeking discovery] to explain how it would use the information," it was unable to explain a specific need for the broad scope of discovery sought, and thus only limited disclosure was required.[14]

When seeking discovery on these grounds, the greater the specificity of need for the information sought, the more likely it is that a court will allow the discovery.[15]

Witness Bias

The sources of litigation financing may be relevant to the bias of potential witnesses. For example, a witness who is financially backing or has a financial stake in the litigation could logically have a bias to see his side prevail.

Important factors that courts have considered when allowing discovery is if the party seeking discovery is able to show specific facts that lead to a reasonable inference that a witness may have bias, as opposed to presenting speculative grounds that may be seen as either a fishing expedition or harassment.

In 2019 in V5 Technologies LLC v. Switch Ltd., the U.S. District Court for the District of Nevada refused to allow discovery into litigation financing when the defendant asserted that it would be relevant to the exposure of potential bias.[16]

The court stated that although discovery into litigation funding may be appropriate when there is a sufficient factual showing of "something untoward" occurring in the case, mere speculation by the party seeking discovery is not sufficient.

The court also stated that it would compel discovery only upon the presentation of some objective evidence that a propounding party's theories of relevance are more than just theories.[17] Also relevant was that the opposing party had already complied with the local rule requiring disclosure of persons with a direct, pecuniary interest in the outcome of the case.[18]

However, courts have allowed discovery into litigation financing when the moving party has been able to raise credible allegations that there may be a bias issue.

In In re: Complaint of Foss Maritime Co. in 2015, the U.S. District Court for the Western District of Kentucky allowed discovery into the details of indemnity agreements with third-party claimants upon concluding that:

> [T]he existence of such a relationship may indicate bias, including by revealing further facts demonstrating that the financing party may benefit from the financed party's triumph, either through the recovery of costs or, when applicable, attorneys' fees."[19]

Here, the movant persuaded the court of a credible inference that the defendant may be paying the expenses — and may be entitled to a share of the proceeds — of third-party claimants, such that the court allowed the discovery.[20]

Real-Party-in-Interest and Standing

Courts have found that litigation financing arrangements are relevant to determining the real-party-in-interest.[21] For example, Judge Connelly, when seeking the information required under his standing order, has repeatedly questioned the parties as to who the real-party-in-interest was.[22]

In In re: Nimitz Technologies LLC last year, he asked:

> Have those real parties in interest perpetrated a fraud on the court by fraudulently conveying to a shell LLC the [patent-in-suit] and filing a fictitious patent assignment with the PTO designed to shield those parties from the potential liability they would otherwise face in asserting the [patent-in-suit] in litigation?[23]

However, bare assertions without articulable reasons will typically result in the denial of discovery.

For example, when a party sought litigation financing agreements in In re: Valsartan N-Nitrosodimethylamine (NDMA) Contamination Product Liability Litigation in the U.S. District Court for the District of New Jersey in 2019 based on assertions of a potential lack of standing of the real-party-in-interest, but failed to articulate a specific reason to believe this was the case, the court denied discovery.[24]

The court noted how "[i]n cases where there is a showing that something untoward occurred, the discovery could be relevant," such as "a sufficient showing that a non-party is making ultimate litigation or settlement decisions, the interests of plaintiffs or the class are sacrificed or are not being protected, or conflicts of interest exist."[25] Because the movant made no such showing, the discovery was denied.[26]

Conclusion and Practice Tips

To help further their clients' interests in this area, practitioners can take the following steps.

If a third party is — or may be — financing the litigation, counsel drafting or seeking discovery of such agreements should focus on whether the agreements contain specific valuations of a patent or other form of intellectual property, as such valuations are more likely to render the materials discoverable.

Counsel should review local rules and standing orders related to disclosure of third-party financing, both when representing a plaintiff bringing a lawsuit and when representing a party responding to a lawsuit, to remain cognizant of the ground rules in given jurisdictions. This may affect the calculus on where to file and whether to seek transfer to another district.

If a practitioner suspects that a litigation adversary is receiving litigation financing, the practitioner should likewise first start with local rules and standing orders for potential disclosure requirements.

Further, a practitioner seeking this information in discovery should conduct a thorough investigation as to be able to provide the court articulable reasons both to make a showing that it is likely the other party is receiving financing, and why the financing is relevant and material to the case.

While bare assertions of bias or speculation of lack of standing likely will not suffice, specificity focused on, for instance, the potential bias of particular witnesses, or articulable grounds standing is lacking for specific claims, will have a much greater chance of leading to discovery.

Counsel should also consider any unique factors that may be pertinent to their situation, and be prepared to argue that these weigh either for or against disclosure. Given the evolving state of the law, courts may be more receptive to such arguments than when the law is well-defined.

Interest in litigation financing is growing, and it will not go away any time soon. Attentive counsel should thus make the potential for disclosure of and discovery into this key issue a part of standard case analysis when prosecuting or defending claims in federal courts.

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[1] See, e.g., C.D. Cal. R. 7.1-1; N.D. Cal. Civil L.R. 3-15; N.D. Ga. Civ. R. 3.3; S.D. Ga. L.R. 7.1.1; N.D. & S.D. Iowa Civ. R. 7.1; D. Md. L.R. 103.3(b); E.D. Mich. L.R. 83.4; D. Nev. L.R. 7.1-1; E.D.N.C. Civ. R. 7.3; N.D. Ohio L.R. 3.13(b); S.D. Ohio Civ. R. 7.1.1; N.D. Tex. L.R. 3.1(c); W.D. Tex. Civ. R. 33.

[2] E.g. Stewart v. Screen Gems-EMI Music, Inc., No. 14-CV-04805-JSC, 2015 WL 13648928, at *2 (N.D. Cal. Jan. 13, 2015).

[3] See https://www.ded.uscourts.gov/sites/ded/files/Standing%20Order%20Regarding%20Third-Party%20Litigation%20Funding.pdf.

[4] Id.

[5] Id.

[6] In re Nimitz Techs. LLC, No. 2023-103, 2022 WL 17494845, at *2 (Fed. Cir. Dec. 8, 2022).

[7] Id.

[8] https://www.law360.com/articles/1687332?scroll=1&related=1.

[9] Fulton v. Foley,No. 17-CV-8696, 2019 WL 6609298, at *2 (N.D. Ill. Dec. 5, 2019) (collecting cases).

[10] Acceleration Bay LLC v. Activision Blizzard, Inc., No. CV 16-453-RGA, 2018 WL 798731, at *3 (D. Del. Feb. 9, 2018).

[11] Electrolysis Prevention Sols. LLC v. Daimler Truck N. Am. LLC, No. 321CV00171RJCWCM, 2023 WL 4750822, at *5 (W.D.N.C. July 24, 2023).

[12] Cirba Inc. v. VMWare, Inc., No. 19-742-LPS, 2021 WL 7209447, *1-3 (D. Del. Dec. 14, 2021).

[13] Id. at *2.

[14] Id. at *3 (limiting litigation financing discovery to "documents that discuss or describe the value of one or more of the patents-in-suit").

[15] See, e.g., Acceleration Bay LLC, 2018 WL 798731, at *3.

[16] V5 Techs. v. Switch, Ltd., 334 F.R.D. 306, 312 (D. Nev. 2019).

[17] Id. (citations omitted).

[18] Id.

[19] In re Complaint of Foss Mar. Co., No. 5:12-CV-21-TBR-LLK, 2015 WL 1249571, at *2 (W.D. Ky. Mar. 18, 2015).

[20] Id.

[21] See, e.g, Cobra Int'l, Inc. v. BCNY Int'l, Inc., No. 05-61225-CIV, 2013 WL 11311345, at *3 (S.D. Fla. Nov. 4, 2013) (litigation financing agreement was "relevant and is not privileged" because the litigation funding agreement is relevant to the issue of standing based on ownership of the patent at issue).

[22] Nimitz Techs. LLC v. CNET Media, Inc., No. CV 21-1247-CFC, 2022 WL 17338396, at *26 (D. Del. Nov. 30, 2022).

[23] Id.

[24] In re Valsartan N-Nitrosodimethylamine (NDMA) Contamination Prod. Liab. Litig., 405 F. Supp. 3d 612, 615 (D.N.J. 2019).

[25] Id.

[26] Id.