

# **COLUMN: ETHICS WATCH: LITIGATION FINANCE (PART II): DISCOVERABILITY OF MATERIALS SUPPLIED TO FUNDERS**

September, 2017

## **Reporter**

29 S. Carolina Lawyer 13 \*

**Length:** 2870 words

**Author:** By Nathan Crystal

## **Text**

---

[\*13] Part I of this article (May 2017) provided an overview of typical structures of litigation finance transactions and discussed whether the transaction might constitute champerty. Whether a finance transaction is champertous depends on which state law applies, so a choice of law clause in a litigation finance agreement is particularly important. The decision of the New York Court of Appeals in *Justinian Capital SPC v. WestLB AG*, 65 N.E.3d 1253 (N.Y. 2016), although finding the particular agreement in that case to be champertous, is actually supportive of litigation finance agreements for the reasons set forth in Part I. South Carolina has aligned itself with jurisdictions favorable to litigation finance by abolishing the doctrine of champerty. *Osprey, Inc. v. Cabana Ltd. Partnership*, 340 S.C. 367, 532 S.E.2d 269 (2000).

A fundamental issue for lawyers considering litigation finance transactions is whether information provided by the client or its lawyers to the funder is subject to discovery by the opposing party. A "must read" opinion for lawyers in considering this issue is *Miller UK Ltd. v. Caterpillar, Inc.*, 17 F. Supp. 3d 711 (N.D. Ill. 2014). The court's encyclopedic opinion covers almost every issue a lawyer should consider when evaluating the discoverability of litigation finance agreements and related documents.

The case involved claims by Miller that Caterpillar, after severing a long-time business relationship between the parties, misappropriated Miller's trade secrets. The court began its opinion by noting that contemporary litigation of major cases often involves a disparity of economic resources between the parties sometimes leading to a "scorched earth" effort by one party, typically the defendant, to overwhelm its opponent. The litigation finance industry developed to offer options to the economically weaker party in litigation. See *id.* at 718, n. 1 (citing the wealth of literature on the litigation finance industry).

The plaintiff Miller had obtained litigation finance assistance, and defendant Caterpillar sought discovery of the actual contract with its litigation funder (the "Deal Documents") and also all documents produced by or provided by Miller to any proposed litigation funder ("Non-Deal Documents"). *Id.* at 719. Caterpillar claimed that it needed these documents to evaluate (1) its defense of illegality to Miller's claims and (2) to determine who was the real party in interest under Rule 17(a) FRCP. Miller objected to

Caterpillar's discovery requests on the grounds that the documents were irrelevant and were protected by attorney-client privilege, work product, and the common interest doctrine.

### **Relevance of litigation finance documents**

Under Rule 26(b)(1) discovery is limited to materials that are "relevant to any party's claim or defense and proportional to the needs of the case." The court held that relevance should not be determined based on whether a prior decision held that a litigation finance agreement was discoverable because results do not determine relevance. For example, if a dispute exists over the percentage that a litigation funder is to receive, the funding agreement is clearly relevant. *Id.* at 723. In *Miller* there was no dispute over the percentage that the funder was to receive.

Caterpillar claimed that the Deal Documents were relevant to its defenses of illegality and real party in interest, so the court proceeded to analyze those defenses. With regard to **illegality**, the court noted that Illinois has a statute making "maintenance" a crime, but the statute requires there to be "officious intermeddling." Officiousness means "volunteering one's services where they are neither asked for nor needed." *Id.* at 725. In this case there was no officiousness by the funder; in fact just the opposite occurred. Miller began the litigation in 2010 without any involvement of the funder and then sought the services of the funder when it became "cash-strapped." Moreover, courts have generally recognized illegality as a defense only in an action between the parties to a contract, not to a separate action that is related to the contract. *Id.* at 726. The court also noted that the trend in the law has been to narrow the doctrine of champerty and related defenses. In conclusion, the court found that it was proper to deny discovery of a matter that is not and cannot be a defense. *Id.* at 727.

Turning to Caterpillar's **real party in interest** contention, the court pointed out that the purpose of the doctrine was to protect the defendant from a subsequent claim by another party actually entitled to recover for the claim. *Id.* at 728. Caterpillar had argued that the funder was the real party in interest because its relationship with Miller was analogous to that [\*14] of insurance company as subrogee to the rights of its insured seeking indemnification from the third party. Quoting Abraham Lincoln, the court treated this argument as bordering on the frivolous because the funder does not pay for losses and does not seek indemnification from a defendant: "Abraham Lincoln was once asked how many legs a donkey has if you call its tail a leg. His answer was four: calling a tail a leg does not make it one." *Id.* at 729.

In conclusion, the court found that the Deal Documents that Caterpillar sought to discover were not relevant to any claim or defense, in particular Caterpillar's alleged defenses of illegality (i.e. champerty or maintenance) and real party in interest.

The court then turned to Caterpillar's claims for discovery of the Non-Deal documents, documents submitted by Miller or its counsel to potential funders. The relevance of these documents was uncontested because they related to claims that Miller might make or defenses that Caterpillar might raise; such documents could be admissible themselves or could lead to admissible evidence. However, Miller claimed that these documents were subject to attorney-client privilege or work product protection.

With regard to the claim of **attorney-client privilege**, the court agreed with Caterpillar that the Non-Deal documents were not privileged for two reasons. First, the transaction between Miller and the funder was a business transaction rather than one in which Miller was seeking legal advice. A communication for purpose of obtaining legal advice is an essential element of the attorney-client privilege. See Restatement (Third) of the Law Governing Lawyers § 68. Note however that advice by Miller's counsel to Miller about

the legal aspects of an agreement with a funder would be privileged because legal advice about a business transaction is subject to the privilege. *Id.* at 711 F. Supp 3d at 730. Second, Miller disclosed the information to a third party; disclosure of information to a third party who is not an agent of either the client or the attorney results in loss of the privilege because the communications are no longer "confidential," another requirement for attorney-client privilege protection, see Restatement § 68, and therefore amount to a waiver of the privilege. 711 F. Supp. 3d at 730.

To avoid the claim of waiver of privilege, Miller invoked the "**common interest**" **exception to the attorney-client privilege**. Under this exception disclosure of information to a third party does not result in loss of the privilege if the client and the third party share a "common interest." If the other elements of the privilege do not apply, the common interest exception is irrelevant. *Id.* at 731. The fundamental issue with the common interest exception is what type of common interest will suffice to satisfy the doctrine. Miller argued that it and the funder had a common interest in the outcome of the litigation, but the court found that this was insufficient. Citing a long list of cases, the court concluded that the common interest must be **legal rather than financial**, including *Duplan Corp. v. Deering Milliken, Inc.*, 397 F. Supp. 1146, 1172 (D.S.C. 1974) (finding that common interest must be legal, not solely commercial). 711 F. Supp. 3d at 734 n.16. This limitation flows from the purpose of the common interest exception: to encourage parties with a shared legal interest to seek legal assistance and to plan their affairs accordingly. *Id.* Of course, the parties might consider hiring a single lawyer but that could create conflict of interest problems.

Finally, the court turned its discussion to **work product protection**. Codified in FRCP 26(b)(3)(A) the doctrine protects from discovery "documents and tangible things that are prepared in anticipation of litigation or for trial by or for another party or its representative." At the core of the work product doctrine are "mental impressions, conclusions, opinions, or legal theories of a party's attorney or other representative concerning the litigation." FRCP 26(b)(3)(B). The rule requires the materials to be prepared "in anticipation of litigation or for trial," but courts are divided on the standard to apply. Some courts use a "primary purpose" test; under this test the primary purpose of the document must be primarily to assist in litigation. Under this test, many documents involved in litigation finance would not be subject to work product protection because they help in financing the litigation but not the litigation itself. (However, a memorandum of law on the strength of various claims and defenses prepared by counsel for the plaintiff would seem to meet this test even if it were shared with the funder.) The second test looks to whether the document was prepared "because of" the litigation; under this test various communications with litigation funders would seem to be protected as work product.

The court recognized that in some cases communication of information to funders might not be in anticipation of litigation - for example, negotiations to establish a loan facility for a law firm to finance a portfolio of future cases. However, on the facts of *Miller* this concern was not a factor because the funding arose after litigation began, so it was clearly in anticipation of litigation. *Id.* at 735.

In the court's analysis of work product, it emphasized an important distinction between work product and attorney-client privilege. While any disclosure to a third party waives the attorney-client privilege (unless the common interest exception applied), disclosure to a third party does not necessarily result in waiver of work product protection. A disclosure to a third party does not waive work product protection unless the disclosure substantially increases the opportunity for potential adversaries to obtain the information. This difference in treatment between the attorney-client privilege and the work product doctrine flows from the different reasons for the protections. The attorney-client privilege protects the attorney-client relationship,

while the work product doctrine supports the integrity [\*15] of the adversary system. *Id.* at 736. The court in *Miller* found that Miller had protected the information it gave to prospective funders from disclosure by written nondisclosure agreements in some cases, and by oral "similar understandings" in others, although it remarked that the plaintiff's declaration was "just barely" sufficient to show an adequate protection of the information from disclosure to adversaries. Moreover, the burden of proof to overcome work product protection rests with the party seeking discovery. *Id.* at 737. In dictum the court indicated that a confidentiality agreement, even an oral one, might not be necessary to preserve work product protection because the circumstances of disclosure to a potential funder might in themselves create a reasonable expectation of privacy. However, the court also found that Miller had waived work product protection by disclosing to prospective funders damage estimates, summaries, and worksheets without obtaining either written or oral confidentiality agreements. *Id.* at 740. The court further found that percentage estimates of success in the case were covered by work product protection; moreover such estimates would be inadmissible under Fed. R. Evid. 403 because their prejudicial effect outweighs their probative value.

*Miller* contains take-aways for both the plaintiffs and defendants and their counsel in cases involving litigation finance.

### **For the plaintiff**

First, fundamental to protecting funding materials from disclosure is use of the work product doctrine because the doctrine, unlike the attorney-client privilege, can apply even when there is disclosure to the third party. However, as the court holds, it is essential that the plaintiff and its counsel prevent the disclosure from increasing the likelihood that the opposing party will obtain the material. A written non-disclosure agreement is the best way to do this; an oral agreement if clear would also suffice, but anything less risks the loss of work product protection.

Second, even if the materials are not protected under attorney-client privilege or work product, the plaintiff may be able to avoid disclosure by showing that the materials are not relevant to any claim or defense or are clearly inadmissible. The court found that Deal Documents themselves were not relevant to either defenses of illegality or real party in interest. In addition, the court found that assessments of the probability of success were not discoverable because such probability opinions would be inadmissible under FRE 403.

### **For the defense**

First, the case quotes defendant's discovery request, which would be a useful model for defendants in other cases. Second, while the court found the "Deal Documents" to be protected from discovery because they were irrelevant to claims or defenses in the case, the court also found that some materials supplied to funders in connection with funding negotiations were relevant, in particular damage computations. Third, the court's rulings turn on a number of facts specific to this case that might not be present in other cases. For example, defendants in other cases could seek the identity of all litigation funders contacted by plaintiff and whether NDAs or other confidentiality agreements were made with such funders. If confidentiality agreements are not present, the defendant may well be able to overcome work product protection. Fourth, the court made several legal rulings that were favorable to plaintiffs seeking litigation funding, but those might be contested in other cases in other jurisdictions. The court used the "because of litigation" standard for work product protection, rejecting the test that focused on whether the materials

were prepared primarily to assist in litigation. Other courts might be persuaded to follow the latter test. In *Miller* the funding clearly met the "in anticipation" of litigation requirement for work product protection because the funding took place after the case arose. Portfolio funding by a lender of a plaintiff's law firm of a certain category of cases to be brought in the future might not meet this requirement. A careful examination of this "must read" opinion will undoubtedly reveal other significant points for plaintiffs, defendants, and their counsel to consider.

One final point, this year the Northern District of California adopted a rule requiring disclosure of the presence of litigation funding in class actions. The court rejected a proposal requiring disclosure of the existence of a litigation funder in all cases. For a discussion of the California rule see California Court Gets Automatic Funding Disclosure Right, [www.law360.com/articles/894351/calif-court-gets-automatic-funding-disclosure-right](http://www.law360.com/articles/894351/calif-court-gets-automatic-funding-disclosure-right). While only binding in the Northern District of California, the court's rule could influence other courts to adopt rules or discovery orders requiring disclosure of litigation funding.

South Carolina Lawyer  
Copyright (c) 2017 South Carolina Bar  
South Carolina Lawyer