A 'Boogeyman' National Security Threat In Litigation Funding

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By **Andrew Strickler** · Listen to article

Law360 (July 21, 2023, 4:54 PM EDT) -- Russian saboteurs targeting America's military through civil litigation. Wealthy actors in the Middle East working behind a wall of secrecy buttressed by lawyers, profiteering investors and unknowing judges. Chinese nationals using proxies to sue Silicon Valley competitors and soak them of sensitive data through discovery.

In recent months, a boogeyman has appeared in the debate about third-party legal investment and the consequences of investor "bets" on the outcome of commercial litigation.

In this narrative, spread by a growing cohort of federal and state lawmakers and influential business groups, a lack of safeguards around the practice is an opening for nefarious foreign adversaries bent on damaging U.S. institutions, be they industry competitors, the government, or American society itself.

By extension, the investment practice itself threatens national security, the argument goes, and should be forced from the shadows to close what one former U.S. House Armed Services Committee chairman recently called a "massive blind spot" in the U.S. legal system.

Those raising the alarm acknowledge a dearth of hard evidence of any such effort. They point to a lack of disclosure requirements in U.S. courts for many kinds of litigants funded by outside interests.

That failing, they say, could allow a foreign adversary to fund, through a legal investment firm, one or many suits meant to impoverish, tire, annoy, or otherwise mess with a company or litigant connected to U.S. national security concerns.

But the cohort, led by the U.S. Chamber of Commerce, can't explain how the threat posed by an overseas adversary, be they a corporate spy or the Kremlin itself, would be enhanced by including an outside investor in such a scheme, or through any perceived failings in court rules or oversight specific to third-party funding.

When pressed, they are also unable to say with any clarity — even under the more extreme hypothetical scenarios — what an adversary would gain by using a legal funding mechanism.

Alex Dahl, general counsel to Lawyers for Civil Justice, a national association representing major corporations and BigLaw that has lobbied extensively for federal civil rules requiring court disclosure of outside litigation investments, said the threat is real, even as "we don't know what we don't know."

Dahl, who spoke recently at a Federalist Society event on Capitol Hill called, somewhat confusingly, "Does Litigation Finance Disclosure Threaten National Security?" likened a disclosure rule to the Foreign Agents Registration Act and other laws meant to protect the U.S. from cloaked foreign influence.

"We simply don't know if this kind of thing is already happening," he said.

When asked to identify a national security concern specific to a case backed by an outside investor, Dahl responded that he saw "no distinction" with the non-security-related concerns long raised by the LCJ and the U.S. Chamber of Commerce about the no-disclosure "loophole."

"There are many reasons a court and parties should know if a nonparty has a direct financial stake in the outcome of a particular case," he said. "National security is an additional reason."

The issue of whether third-party investors should be revealed in court has been central to the broader, yearslong debate about legal investing.

Unsurprisingly, the business-and-defense interests, spearheaded by the U.S. Chamber of Commerce, have lobbied, with limited success, for court rules and laws requiring disclosures in court. Funding contracts typically come with strong nondisclosure agreements meant to keep the terms of contracts with litigants and lawyers, and their very existence, out of the public eye.

Major legal-focused investors, as well as hedge funds and smaller players, have enjoyed massive growth over the last 15 or so years. From their point of view, these are private financial transactions, not unlike bank financing or contingency deals common to civil

litigation, that are not relevant to the merits of the legal claims they fund. Thus, they should not be burdened by disclosure rules that could be exploited by the defense to gauge a litigant's resources and drive down settlements.

Amid copious state and federal lobbying, conference panel talks and government reports, little, if anything, had been said in recent years about national security before last fall. In November, the Chamber released a report on the topic that got the ball rolling.

The report, commissioned from a team at Skadden Arps Slate Meagher & Flom LLP, discussed the "new" security risk posed by the practice and growing concern that foreign money is pouring into the legal system for nefarious purposes.

Citing a 2011 research paper that noted the possibility that a Chinese entity could use an outside funding deal to sue a U.S. military technology company or other "sensitive industry," the paper argues that the legal investing provides a "clear path" for such efforts. Chiefly, that risk is manifest in the lack of disclosure requirements, the report argues, and evidence that funders can and do exercise some level of control or influence over cases they back.

"While the ability of a third party to fund or direct the strategy of a case or portfolio of cases is problematic in and of itself, the risks are compounded when a foreign government is the one funding or exerting that control, particularly given that such influence would be completely unknown" to the parties or court, the paper states.

While acknowledging a lack of real-world examples, the paper posits a number of scenarios in which U.S. adversaries could weaponize funded lawsuits and seize control of sensitive information.

The report ties those possibilities to well-recognized topics of concern to the U.S. legal community: patent litigation abuse; suits designed to harm corporate reputations; and social media disinformation, among others.

"Given the lack of transparency … there are, unfortunately, few practical barriers in place to prevent foreign adversaries like China, Russia or Iran from covertly financing politically charged lawsuits — including those challenging the results of U.S. elections — with the purpose of enflaming passions and exploiting domestic political divisions to advance their strategic interests," the report states.

Those themes have gotten some traction of late, bubbling up during investor conference Q&As and in public commentary on proposed patent and trademark rules.

In December, 14 state attorneys general, all Republicans, urged the Justice Department to act on growing concerns about the possibility that China or Russia could use a funding deal for lawsuits meant to "weaken U.S. national defense companies in the business of protecting our national security interests."

In an op-ed published in April, Howard McKeon, a former chairman of the House Armed Services Committee, citing the Skadden report, called intellectual property a "bedrock" of U.S. national and economic security that has been increasingly in the crosshairs of spurious litigation and foreign players.

"The longer we wait to put a spotlight on litigation investment entities, the larger the threat grows, and the farther away we are from finding solutions," he wrote.

This year, lawmakers in Louisiana passed a funding disclosure bill targeting "hostile governments" pursuing trade secrets and other sensitive data. The bill, known as the Litigation Financing Disclosure and Security Protection Act, required a party to provide any outside funding contract to all other parties, including in the context of personal injury litigation.

Gov. John Bel Edwards vetoed the legislation, which he called a "pretense" designed for courtroom advantage "under the guise of promoting transparency in litigation and protecting national security."

The sponsor of the bill, Sen. Barrow Peacock, said he supported disclosure even before becoming aware of recent reports about the national security threat. He also raised concerns about entities buying land near Louisiana military bases, "coastal lawsuits," and energy infrastructure.

Peacock was unable to say what the legal investment approach would provide a nefarious state actor that wouldn't be available by directly funding cases or collaborating with a domestic "proxy" claimant.

"If they can keep hiding, you will never know, so that's the point of the bill," he told Law360.

The issue also has the attention of major funders. Andrew Cohen, a senior vice president at Burford Capital, called it "classic logrolling," and largely illogical even as a hypothetical.

In a funder-lawyer relationship, the funder is not privy to information subject to court protective orders or otherwise confidential, he said. And in the "bad actor" investor scenario, the inclusion of a funder would put another layer between the plaintiff and the outside entity targeting sensitive information held by the defendant

"I don't know why litigation funding would be part of this picture, other than to add yet another level of indirection away from the information that they want, in theory, to get," he said.

"We would be talking about multiple steps away from where the information is, and in order for it to get to a third party … you would have to have people all along on the way violating laws or ethical procedures to get information out from where it's supposed to be."

Others agreed that chain of complicity would have to run through the "named" plaintiff and their counsel, through the outside investment firm, and then to the overseas entity. Large funds with experience in big-dollar cases raise pools of investor money and do not give investors a choice on which individual cases are funded, adding another complication to the picture.

Plaintiff-side attorney Adam Mortara, who has worked on dozens of funded litigations and was Dahl's counterpart at the Federalist Society discussion, called the scenario "absurd" and a "boogeyman" created by opponents of legal funding.

For such a scheme to be successful, he said, a string of people would need to suborn perjury and violate court protective orders, as well as their professional and ethical obligations. Those barriers would likely discourage, rather than entice, a nefarious foreign actor.

"The argument is evidence-free, and requires almost QAnon-level conspiracy thinking to believe this would or could happen," he said. "There are easier ways to conduct corporate espionage … through other means for which we have seen actual examples deployed."

In an interview this week, Page Faulk, senior vice president of legal reform initiatives at the U.S. Chamber's Institute for Legal Reform, defended the report. She pointed to recent lawmaker support for the notion that the dearth of disclosure requirements represents a legitimate threat.

U.S. adversaries "will use any means possible to get at the United States," she said. Faulk was unable to identify a potential motive or additional benefit a foreign adversary would get by utilizing a third-party funding agreement.

"I go back to the fundamental point that we need more transparency around third-party investors that are not disclosed currently," she said.

--Editing by Robert Rudinger.

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