

# An Overall View of the Litigation Funding Industry

BY LAZAR EMANUEL

On January 16, the New York Times ran a front-page story whose general thrust was set by the headline, “Lawsuit Loans Add New Risk for the Injured.” The article was a collaboration between the Times and the Center for Public Integrity, a “non-profit journalism group in Washington.” The article described the burgeoning industry of litigation funding as follows:

The business of lending to plaintiffs arose over the last decade, part of a trend in which banks, hedge funds and private investors are putting money into other people’s lawsuits. But the industry, which now lends plaintiffs more than \$100 million a year, remains unregulated in most states, free to ignore laws that protect people who borrow from most other kinds of lenders.

Unrestrained by laws that cap interest rates, the rates charged by lawsuit lenders often exceed 100 percent a year, according to a review by *The New York Times* and the Center for Public Integrity. Furthermore, companies are not required to provide clear and complete pricing information — and the details they do give are often misleading.

This description of the industry raises many questions that need answers: How big is the industry? Who are the principal players? Who determines whether financing will be made available for a particular lawsuit? What is (or should be) the role of the plaintiff’s lawyer in the application for funding? What are the laws that the industry has ignored? How in fact does the lender determine its interest rates? Its share of the amount recovered? Should the courts and the state legislature impose controls over the industry? Over the interest rates?

These questions all raise issues for the Bar and for the public as a whole. If we don’t answer them soon, we may find that the answers have been imposed upon us by the financial markets. Because we have recently been forced to observe once again the perils of allowing the free market to control our financial institutions, we cannot afford to allow this to happen.

**Scope of the problem.** The funding of law suits by anyone but the plaintiff has troubled society from its earliest days. In early England, Parliament recognized the problem by passing laws outlawing Champerty and Maintenance. In its original sense, Champerty meant the lord’s share in the crop raised by his tenant. Later, it came to describe the practice of men of title and wealth to buy up and collect the claims of the poor and indigent. To protect the interests of the rightful owners of these claims, Parliament declared champerty a crime and all agreements of champerty void. As one English judge defined it:

In modern idiom maintenance is the support of litigation by a stranger without just cause. Champerty is an aggravated form of maintenance. The distinguishing feature of champerty is the support of litigation by a stranger in return for a share of the proceeds.

As recently as 2006, Webster’s New World College Dictionary, Fourth Edition, defined *Champerty* as:

An act or proceeding by which a person who is not concerned in a lawsuit makes a bargain with one of the litigants to help maintain the costs of the suit in return for a share of the proceeds; illegal in most states.

The Court of Appeals dodged the opportunity to define what constitutes champerty in New York in the case of *Trust v. Love Funding Corporation*, 13 N.Y.3d 190 (2009). (See, also, my article, *Litigation Funding and the Law of Champerty*, NYPRR July 2010.)

In *Trust v. Love Funding*, a group of investors in a series of pass-through certificates issued by Merrill Lynch Mortgage Investors formed a Trust to consolidate and collect a number of claims. One of the claims was against a company named Love Funding Corporation. Love Funding was the mortgagor under a mortgage loan made by an assignor to UBS Real Estate Securities, Inc., which assigned to the Trust its right to sue Love Funding for misrepresentations in its original loan application.

In the suit by the Trust against Love Funding, *Trust v. Love Funding*, 499 F. Supp. 2d 314 (S.D.N.Y. 2007), District Court Judge Shira A. Scheindlin voided the assignment from UBS to the Trust as champertous and entered judgment in favor of Love Funding.

On appeal by the Trust, the Circuit Court confronted the need to review and apply New York's law on champerty and maintenance. Recognizing that the law in New York was confusing and ambiguous, the Circuit Court certified three questions to the Court of Appeals:

1. Is it sufficient as a matter of law to find that a party accepted a challenged assignment with the "primary" intent proscribed by New York Judiciary Law § 489(1), or must there be a finding of "sole" intent?
2. As a matter of law, does a party commit champerty when it "buys a lawsuit" that it could not otherwise have pursued if its purpose is thereby to collect damages for losses on a debt instrument in which it holds a pre-existing proprietary interest?
3. (a) As a matter of law, does a party commit champerty when, as the holder of a defaulted debt obligation, it acquires the right to pursue a lawsuit against a third party in order to collect more damages through that litigation than it had demanded in settlement from the assignor?  
(b) Is the answer to question 3(a) affected by the fact that the challenged assignment enabled the assignee to exercise the assignor's indemnification rights for reasonable costs and attorneys' fees?

Inartful and cumbersome though these questions were, the Court of Appeals (Pigott, J.) answered:

We hold that a corporation or association that takes an assignment of a claim does not violate Judiciary Law § 489 (1) if its purpose is to collect damages, by means of a lawsuit, for losses on a debt instrument in which it holds a pre-existing proprietary interest.

We answer the second certified question, and both parts of the third certified question, in the negative. Because — as the Second Circuit itself hinted — "the critical issue to assessing the sufficiency of the champerty finding is not the denomination of the Trust's intent as 'primary' or 'sole,' but the purpose behind its acquisition of rights that allowed it to sue Love Funding" (556 F3d at 111), we find it unnecessary to answer the first certified question.

A careful reading of the opinions of Judge Pigott and of the Circuit Court would entitle us to conclude that there are two possible constructions of the term "champerty", one defining what champerty *is*, and the other defining what champerty *is not*.

1. **What champerty is not:** The purchase and/or funding of a law suit which seeks to enforce a pre-existing determinate right — whether a debt, a lien or a valid assignment — does not constitute champerty.

*[t]he champerty statute does not apply when the purpose of an assignment is the collection of a legitimate claim. What the statute prohibits, as the Appellate Division stated over a century ago, is the purchase of claims with the 'intent and for the purpose of bringing an action' that. ... may involve parties in costs and*

*annoyance, where such claims would not be prosecuted if not stirred up . . . in [an] effort to secure costs.*  
(quoting from the opinion of Pigott, J.)

- 2. What champerty is:** The purchase and/or funding of a law suit by advancing or making a loan to a plaintiff seeking damages which are indeterminate at the time of filing, for an injury to person or property, constitutes champerty as defined in Section 489 of the Judiciary Law; *also*, champerty is the business of acquiring a financial interest in a litigation, by an individual or company other than the plaintiffs, the defendants, their lawyers, and their insurers

*In describing champerty in terms of an acquisition made with the purpose of bringing a lawsuit, we intended to convey the difference between one who acquires a right in order to make money from litigating it and one who acquires a right in order to enforce it.* (quoting from the opinion of Pigott, J.)

Thus, relying on the exchanges in *Love Funding*, we may reasonably conclude that in New York, the doctrine of champerty is still alive and well, and that lenders who offer financing to plaintiffs to fund a lawsuit asking for indeterminate damages may be guilty of violating Section 489.

**The industry of litigation funding.** As the Times pointed out, lenders in the business of litigation financing run the gamut from private investors, to partnerships and corporations, to hedge funds, and to banks. The roster of lenders includes the 20 members of ALFA, a trade association with offices at 228 Park Avenue S. in New York. The New York Times article mentioned the following lenders: Oasis Legal Finance, a lender in Northbrook, IL (not, apparently, a member of ALFA); Cambridge Management Group, (not a member), with offices in Glen Rock, NJ; and LawCash, whose founder is Chairman of ALFA. LawCash has offices in Brooklyn and Florida and claims to be “The Leading Provider of Legal Financing...Funding Plaintiffs and Attorneys.”

In an earlier article (November 14, 2010, the New York Times named two other sources of litigation funding: Counsel Financial, a company in Buffalo financed by CitiGroup, which, according to the Times, funded the lawsuit in behalf of the ground zero workers which was settled in June 2010, and, in the process, earned \$11 million dollars on a loan of \$35 million dollars; and Ardec Funding, a lender in Manhattan backed by a hedge fund, which, again according to the Times, earned \$900 a month on a loan of \$45,000 to support a personal injury claim, or 24%. On its website, Counsel Financial claims:

We provide attorneys with flexible revolving credit lines **up to \$5 million+** using the value of your contingent case as collateral. Today, we are the largest provider of attorney loans in the United States and the *only* Law Firm Financing company *endorsed* by the American Association for Justice, American Trial Lawyers Association, Consumer Attorneys of California, North Carolina Advocates for Justice, and Kentucky Justice Association.

The key to the success of firms which offer litigation funding is exemplified by a statement made by LawCash on the home page of its website, [www.lawcash.net](http://www.lawcash.net): IF YOU DON’T WIN OR SETTLE YOUR CASE, YOU OWE LAW CASH NOTHING. Borrowers are not required to pay the lenders anything if they lose. The concept of “no win, no loss” enables these lenders to claim that the advances they make are really investments or a form of financing or funding. According to the Times, this claim “has persuaded regulators in many states, including New York, that lawsuit lenders are not subject to existing lending laws.” The Times does not explain how regulators in New York came to be persuaded, or how the “persuasion” was manifested. In view of the decision in *Trust v. Love Funding, supra*, there would appear to be no support for the statement by the Times.

The LawCash website offers us insight into the practices of litigation lenders. The website describes the business as:

LawCash litigation financing allows personal-injury victims, lawsuit plaintiffs, and attorneys to pay expenses and manage cash flow while awaiting the resolution of their claims. To support pre- and post-settlement litigation financing, LawCash places a lien on a portion of the future proceeds of the lawsuit.

LawCash offers litigation support to plaintiffs and to their lawyers. Plaintiffs can apply to LawCash directly, but we can assume, as a practical matter, that the application will normally be prepared by or in consultation with the lawyer. The firm will also extend financing to lawyers directly in a variety of ways. These may be described as:

1. The funding of litigation costs and expenses anticipated or incurred by the lawyer.
2. Pre-settlement funding of attorney fees.
3. Loans to lawyers and law firms for such business expenses as advertising, payroll, case costs or other operating expenses, depending upon the size of a lawyer's practice, the amount requested, and the number of open cases.
4. Case cost lines of credit. [These] differ from attorney lines of credit in that funds advanced through a case cost line of credit are to be used to pay case costs exclusively, while attorney line of credit funds may be used to pay firm operating expenses as well as case costs.

LawCash expects the plaintiff's lawyer to cooperate in the preparation of the funding application.

This form [the Application and Disclosure Form] authorizes LawCash to contact you about the claim so that we can begin the evaluation and underwriting process. We might ask you to provide medical reports, emergency room reports, accident reports, expert testimony, insurance information, information about the current status of the litigation, and any other details that would help us to make our decision. If, after reviewing the application, LawCash approves your client's litigation financing request, we will enter into a Funding Agreement with your client.

The Funding Agreement will set forth the amount of the lawsuit funding advance and the amount owed to LawCash if the plaintiff secures a settlement or award. We will send the Funding Agreement to you for your signature so that our interests are protected. Other than providing preliminary information in the application process and sending LawCash our fees and repayment before forwarding the settlement or award proceeds to your client, you will have no contact with LawCash.

### **NYSBA Ethics Opinion 666**

LawCash relies for its authority to offer and execute litigation funding agreements on the Ethics Opinions of State Bar Associations. For funding in New York, it relies on Ethics Opinion 666, issued in 1994 and interpreting the old Code of Professional Responsibility. The question asked in the NYSBA Opinion was:

May a lawyer refer a client to a financial institution that will lend the client money for living expenses, where the repayment of the loan is contingent on the successful resolution of the client's claim for personal injuries?

The Opinion offers little solace and support to sources of litigation funding.

Whether, or to what extent, those concerns [the perceived evils addressed by the traditional prohibition {against} the stirring up of unmeritorious litigation and the improper solicitation of retainers to pursue it] continue to be viable in an age of widespread lawyer advertising, and whether

the proposed conduct should be deemed “indirectly” paying a client for the placement of a retainer in construing the rule against maintenance, are matters of law on which this committee does not opine. Thus, in answering the question, we express no opinion as to whether the proposed conduct would violate the substantive law of New York. If what is proposed is illegal, then it would perform be unethical. ...

Ethically, the principles underlying the traditional ban on maintenance found their expression in DR5-103 (B). That rule prohibits a lawyer from advancing litigation expenses, the repayment of which is contingent on the outcome of the claim, because the client must remain “ultimately liable” for the expenses. ...The client must bear those expenses regardless of the outcome of the claim. ...

In the instant matter, the lawyer does not propose to “pay” or “advance” any part of the loan. The lawyer’s sole function would be to refer the client to a lending institution that then would assess the value of the claim and take a lien on its proceeds to secure the loan. Thus, a mere referral to the lending institution would not be unethical per se. ...

The lawyer must be careful not to compromise confidentiality in disclosing information to the lending institution. The client must be made aware of such a possibility and any disclosures to the lending institution by the lawyer should be made with the fully informed consent of the client. ... Furthermore, the lawyer cannot own an interest in the lending institution.

Finally, the lawyer cannot be paid a fee or receive any other compensation from the lending institution.

NYSBA Opinion 666 represents one of the first times in which the New York bar considered the relationship between lawyers and the companies engaged in the business of litigation financing. In the succeeding years, with the growth of companies like LawCash and Counsel Financial, lawyers have become inextricable links in the process of arranging financing for all kinds of litigation. The question we have to answer is: does a lawyer who participates actively in the financing process violate Section 488 of the Judiciary Law by imposing the duty of repayment of costs and expenses on a contingent client? The answer lies in the relationship among the lender, the lawyer, and the client. The lender waives all right to repayment – of interest and principal – if the suit is unsuccessful, and the contingent client gets the benefit of the “No Win, No Loss” doctrine.

Of course, if there is recovery, the lender is entitled to get its money back, and the lawyer becomes the collection agent of the lender.

### **The Steep Price of Funding**

Because the lender faces the possibility that it will recover nothing, litigation loans come at steep prices. Arguments to support these prices are the backbone of the litigation financing industry. The New York Times expresses it this way:

Companies...say that they must charge high prices because betting on law suits is very risky. Borrowers can lose, or win, less than expected, or cases can simply drag on, delaying payment until the profit is drained from the investment.

To fortify its position, the industry has started volunteering to be regulated – but on its own terms. The companies, and lawyers who support the industry, have lobbied state legislatures to establish rules like licensing and disclosure requirements, but also to make clear that some rules, like price caps, do not apply.

We of the New York Bar have not ventured into the fray to understand and assess the benefits and detriments of litigation funding. In the meantime, other states have attempted to show us the way. In Ohio, for example, the funding industry faced an adverse decision in *Rancman v. Interim Settlement Funding Corp.*, 99 Ohio St. 3d 121 (2003). The Supreme Court of Ohio held:

We are asked to address whether a nonrecourse advance of funds secured solely by an interest in a pending lawsuit and at a contracted return exceeding 180 percent per year is permissible under Ohio law. We hold that it is not. Such an agreement constitutes champerty and maintenance and thus is void under Ohio law.

The Court reasoned:

Equally troubling is a champertor's earning a handsome profit by speculating in a lawsuit and by potentially manipulating a party to the suit. ...However, a lawsuit is not an investment vehicle. Speculating in lawsuits is prohibited by Ohio law. An intermeddler is not permitted to gorge upon the fruits of litigation.

Ultimately, the Ohio legislature acted to soften the impact of the *Rancman* decision. In 2008, it passed HB 248, a bill stating that litigation financing could proceed, but that the contract with the lender had to include the following: the dollar amount of the advance; the total amount to be repaid in each six-month interval; the annual percentage rate; a five-day right-to-cancel clause; and an acknowledgment by the litigant's attorney that he had reviewed the contract. Similar legislation was passed in Connecticut in 2008 and in Maine in 2009.

If other states can move to regulate the litigation finance business, why can't we? Why do we have to rely instead on an exchange of confusing questions and answers by our Courts?

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