THE LITIGATION FINANCING INDUSTRY: THE WILD WEST OF FINANCE SHOULD BE TAMED NOT OUTLAWED

by

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I. INTRODUCTION

Lending money to plaintiffs to finance their lawsuits has become an industry within the last ten years. Before the emergence of this industry, little attention was paid to: 1) how injured plaintiffs managed financially while waiting years for their cases to be resolved, and 2) the distinct disadvantage suffered in the settlement and litigation processes by those who could not afford to wait.[1] The litigation financing firms make non-recourse loans to plaintiffs in exchange for a share of the proceeds of their lawsuits, if there are any. If a plaintiff loses, nothing is repaid, and the lender loses the money advanced. One lender in the industry has described his business as being "the Wild West of finance."[2] This description is apt because it is not clear how the law does control or should control these transactions.

The confounding factors affecting the industry are states' prohibitions on champerty, state usury laws, consumer activist opposition to predatory lending, and the ease with which Internet businesses can be started. Anyone can put up a web site on the Internet announcing that he or she will provide money to plaintiffs who cannot pay their bills while their legal claims are being litigated. A plaintiff may not mind that if he wins his lawsuit, he will have to repay the principal advanced plus ten percent per month in interest because without the loan, he would be forced to accept any settlement offer, no matter how low. An upstate New York electrician provides an example.

Thomas Knauer suffered a serious brain injury when he fell off a high ladder while installing electrical service.[3] He and his wife were besieged by creditors while they waited for their workers' compensation case and other litigation to be resolved.[4] The Knauers contacted a litigation financing firm that advanced $13,500 to them which they would repay with about fifty percent interest per year if, but only if, they collected any money from the defendants or their insurance companies.[5] Mrs. Knauer was very pleased with this arrangement because she said the $13,500 "made a huge difference in my life."[6]

The legal issues surrounding the described transaction include whether the agreement is an illegal violation of prohibitions against champerty; whether the agreement is an illegal violation of usury statutes; whether the lender is a predator taking advantage of an unprotected borrower; and ultimately, whether the industry should be left alone, regulated to some extent, or regulated out of business.

This article will provide a brief background on the issues of champerty and usury and will then focus on recent state court decisions about the enforceability of litigation financing agreements. The article then looks at subprime lending in general to determine if litigation financing belongs in the general category considered "predatory." Finally, the article concludes that litigation financing firms can provide a worthwhile service to level the playing field in lawsuits when defendants have much greater resources available than plaintiffs, but such firms must be regulated to force meaningful disclosure of the terms of the financing agreement so that borrowers can choose the firm that offers the best deal. Furthermore, the government, rather than eliminating litigation financing firms, should encourage traditional lenders to enter the industry to bring competitive market forces to bear on the rates charged to plaintiffs for the financing.

II. CHAMPERTY AND USURY PROHIBITIONS: THE HINDRANCES TO LITIGATION FINANCING

Champerty, an arrangement in which a third party supports another's litigation in exchange for a share of the proceeds if there are any, has been prohibited by law since ancient times.[7] The reasons for the prohibition have included a desire to discourage frivolous litigation, quarrels, resistance to settlement, and interference in the attorney-client relationship.[8] Nevertheless, in the United States, even in states that have maintained the prohibition against champerty in general, there have always been exceptions to the prohibition. The most widespread is the universal use of the lawyer's contingency fee. The contingency fee became accepted because allowing an impoverished plaintiff to bring a legitimate cause of action was viewed as more important than preventing the alleged evils of champerty which could, in any case, be eliminated by rigorous supervision by the courts.[9]

Furthermore, over the years, common law in many states has eliminated the prohibition on champerty or has found in a variety of circumstances insufficient reason to enforce it.[10] Most notably, New Jersey has always permitted and enforced champertous agreements;[11] and in 1997 the Massachusetts Supreme Judicial Court held that the state would no longer recognize the prohibition on champertous agreements.[12] Outside the United States, other common law countries have increasingly been relaxing prohibitions on champerty.[13]

The chance that the lenders would not get their principal and fees if the financed plaintiff won or that the plaintiff's case would be dismissed because of the champertous third party financing, was the main deterrent to making these arrangements. When court opinions refusing to enforce the champerty prohibition[14] started to appear, at the same time that reaching customers on

the Internet became an easy and efficacious way to conduct business, the circumstances were ripe for an explosion of litigation financing firms.

The other chief potential legal impediment to this new industry was usury statutes. Usury, the act of lending money at an unlawfully high rate of interest, is another ancient legal doctrine.[15] The world's first recorded usury law, setting a maximum allowable interest rate cap, was part of the Babylonian Code of Hammurabi written in 1750 B.C.E.[16] It limited rates to about twenty percent a year for loans on silver and thirty-three percent per year on loans on grain.[17]

Today most states in the United States have statutes setting interest rate limits and prohibiting usury.[18] In most states, the elements of usury are: (1) an agreement to lend money; (2) the borrower's absolute obligation to repay with repayment not contingent on any other event or circumstance; (3) a greater compensation for making the loan than is allowed under a usury statute or the State Constitution; and (4) an intention to take more for the loan of the money than the law allows.[19] It is the second element that is arguably missing in the typical litigation financing agreement because the borrower's obligation to repay is contingent on the borrower's success in the litigation.

III. THE OHIO SUPREME COURT WOUNDS THE LITIGATION FINANCING INDUSTRY: RANCMAN V. INTERIM SETTLEMENT FUNDING CORPORATION

Roberta Rancman was seriously injured when she was a passenger in a car.[20] She sued State Farm Insurance Company for benefits under an uninsured motorist policy issued to her husband from whom she was separated.[21] Shortly after filing suit, Rancman entered into an agreement with Future Settlement Funding Corporation (FSF) in which FSF agreed to give her $6,000 in exchange for her promise to give FSF $16,800 if her case were resolved within twelve months, $22,200 if the case were resolved within eighteen months, or $27,600 if it were resolved within twenty-four months.[22] She entered into a second agreement with Interim Settlement Funding Corporation (ISF) in which ISF agreed to give her $1000 in exchange for her promise to pay $2,800 from the proceeds of her case.[23] If Rancman did not recover anything from State Farm she would not have to pay anything to FSF or ISF; she would keep the funds they had advanced to her.[24]

Rancman settled her case with State Farm for $100,000 within twelve months of her agreement with FSF.[25] Instead of paying FSF $16,800 and ISF $2,800 as required by her agreements, Rancman returned the $6,000 and $1,000 advanced with eight percent interest per year, and she sued FSF and ISF for a rescission of the contracts and a declaratory judgment that the contracts were "'unfair, deceptive, and unconscionable sales practices.'"[26] A magistrate, the trial court, and the intermediate appellate court in Ohio held that Rancman's transactions with FSF and ISF were loans.[27] The appellate court reasoned that there was no real probability that State Farm would not pay Rancman and, therefore, the agreements were loans because there was no contingency.[28] The court's holding meant that FSF and ISF could not collect anything from Rancman, neither interest, nor principal, nor any other fees.[29]

FSF and ISF appealed to the Ohio Supreme Court which declined to decide whether the money they advanced to Rancman were loans or investments, noting that there was no legal limit on a return on investments.[30] Instead, the court returned to the old champerty prohibition, declaring the agreements void because they were champertous.[31] The court thus achieved the same result as the lower courts, but it, *sua sponte*, used entirely different reasoning and arrived at an entirely different legal conclusion.

The court gave a brief history of champerty in Ohio citing cases from 1823,[32] 1902,[33] and 1908[34] to assert that champerty has always been "vilified" in Ohio.[35] The court, nevertheless, admitted that in recent years champerty has "lain dormant in Ohio courts."[36] It is interesting to speculate why the court resurrected this doctrine when none of the parties in the case requested it.[37] First, one might assume that because Rancman would have had to pay an, arguably, very high rate of return on the money advanced to her, the court wanted to affirm the lower courts' result. A visceral reaction to the terms of the agreements might assume a poor, unprotected plaintiff being taken advantage of by sophisticated, well-financed, wise-guy lenders. If that were the court's mind-set, it could have just affirmed the appellate court's decision that the transaction was a loan and declared it usurious. The lower court's reasoning was problematic, however. It required the conclusion that there was no possibility that Rancman would fail to collect from State Farm either in litigation or in a settlement. If there was a contingency, then the money advanced was an investment, not a loan, and there could be no usury. The Ohio Supreme Court clearly did not want to undertake the determination of "the threshold level of risk necessary for a contingent advance to be treated as an investment rather than a loan."[38] It avoided making that determination by choosing to invoke the prohibition on champerty instead.

The court focused on Rancman's disincentive to settle the case because of her agreements with FSF and ISF.[39] For example, the $7,000 in advances made it unreasonable for Rancman to settle for $28,000 or less.[40] She would have had to pay FSF $16,800 and ISF $2,800 and a thirty percent contingency fee to her lawyer. With no other liens, she would not have gotten any additional money unless the settlement was for more than $28,000. Thus, the court concluded that the financing arrangements could prolong litigation and reduce incentives to settle, evils the prohibition against champerty is supposed to cure.[41] The court did not consider the pressure on the plaintiff to settle her case for an unfairly low offer by the defendant if the plaintiff had no money to pay her living expenses while she waited for the proceeds from her case.

The court was also disturbed by "a champertor's earning a handsome profit by speculating in a lawsuit" and by the possibility that a party would be manipulated.[42] In this case there was no evidence that Rancman was manipulated. Rancman testified that she knew the terms of the agreements.[43] Furthermore, she had an attorney, and she specifically rejected his advice

not to enter into the agreements.[44] The court clearly did not like the financial arrangement that was at issue in this case and was determined to declare it void. Unfortunately, it did not do a well reasoned analysis of its concerns about the financing arrangement, namely, the effect on litigation, the disadvantage of the financed party, and the amount of money earned by the lenders.

Ohio is not the only state that has recently affirmed its common law champerty prohibition. The Nevada District Court did so in *Resolution Settlement Corp. v. Curry*.[45] The court recounted that Curry contacted Resolution Settlement Corporation (RSC) seeking financing to fund an appeal from a jury verdict in her favor.[46] RSC had discussions with Curry and her attorney, and then provided two advances pursuant to Curry's requests on two separate occasions.[47] Each time Curry executed an agreement that provided that RSF would get paid only if Curry won the underlying case and there were sufficient funds to pay attorney's fees, cost, and any other liens first.[48] Curry agreed that if she won her case she would pay RSF twenty-five percent or $1.2 million, which ever was greater, of the funds recovered.[49] Curry won and refused to pay RSF.[50] RSF sued to recover under its contract or in quantum meruit and lost.[51] The court noted that other states had eliminated prohibitions on champerty, but asserted that Nevada had not, citing several Nevada Supreme Court holdings.[52]

While *Curry* is an example of a court merely following a long-held precedent, the *Rancman* case is an excellent example of the more emotional problems faced by the litigation financing industry: courts just do not like it. There is something unseemly about investors making money by betting on the outcome of litigation; investors making a lot of money for risk that sometimes may be limited; investors making money in circumstances involving people who do not have any. All these factors make litigation financing seem like just another example of predatory lending.

IV. Predatory Lending and Subprime Lending

Many commentators have written about high-cost lending by predatory lenders.[53] Their purpose is generally to sympathize with and reform the plight of "low-income communities, racial and ethnic minorities, women, the undereducated, and the elderly" who are the victims of predatory practices.[54] Although there is no legal definition of predatory lending,[55] the term usually refers to situations in which borrowers do not understand the terms of the loan and all material information is not disclosed to them; lenders put undue pressure on borrowers knowing that borrowers have insufficient resources to make loan payments; and lenders target vulnerable borrowers.[56] Generally, predatory practices do not occur in the prime lending market because there is greater competition among banks, thrifts, and credit unions which are, in addition, heavily regulated by state and federal agencies.[57] Furthermore, prime borrowers are more likely to understand the financial transactions and to shop around for the best terms.[58]

The U.S. Department of Housing and Urban Development recounted the following example of predatory lending. A seventy-one year old woman was visited by a mortgage broker who promised that he could refinance her existing mortgages so that her monthly payments would be less and she would receive an extra $5,000 in cash with which she could make the kitchen repairs she needed.[59] His friendly manner earned her trust and persuaded her to sign the loan documents although she could not read them because of poor vision and limited education.[60] The result was that her monthly payment increased to eighty percent of her monthly income, she received no cash, and the broker received $9,100 as a fee.[61] Such stories abound in the predatory lending literature, but they are far older than the recent interest of consumer advocates. They were the original reasons for ancient usury laws:

> Such [usury] laws are intended as a bulwark to protect the needy from the greed of the rapacious. It is the theory of such enactments that those in distress might be plunged into deeper distress if the law did not come to their relief and protect them from the money lender, who would prey upon misfortune and wring from the needy borrower, in his endeavor to tide over present difficulty, the utmost farthing as compensation for what is often an evanescent benefit–merely the putting off of an evil day.[62]

Such stories should not lead, however, to the conclusion that all subprime lending is predatory. Subprime lending is generally defined as "the extension of credit to higher-risk borrowers who do not qualify for traditional, prime credit[, m]ost often [because of] borrowers' tarnished credit records or uncertain income prospects. . . . Subprime loans . . . feature pricing and other contract terms that either compensate for or are intended to lessen some of these risks."[63] In the last ten years subprime lending has increased dramatically because of credit assessing tools that have allowed lenders to institute more profitable risk-based pricing.[64] For example, the subprime auto finance market has increased from about $15 billion in loans in 1992 to between $65 billion and $125 billion in 2002.[65] During that same time period subprime lenders helped increase minority home ownership to record levels by opening the home mortgage market to low-income and minority borrowers.[66] By 2002, subprime mortgage originations were about eight and half percent of all mortgage originations in the United States.[67] Between 2002 and 2003, the total volume of subprime lending increased by more than fifty percent, from $213 billion to $332 billion.[68]

When the subprime market operates efficiently, it provides opportunities for low-income borrowers to buy homes, to buy cars and other goods by obtaining credit that is unavailable to them in the prime market. Most commentators on credit issues, critics and lenders alike, agree that credit should be available to as many borrowers as possible.[69] However, there is disagreement about how well the subprime market is working and how it should be regulated because there is little empirical evidence about these questions.[70] Subprime lenders argue that they charge more because they are assuming greater risk and, in fact, low-income borrowers are more likely to default on loan payments.[71] Consumer advocates argue that not all low-income borrowers default,

and new risk assessment technologies allow lenders to distinguish the good risks from the bad ones.[72] One academic expert has noted the misconceptions that exist about subprime borrowers: anecdotal evidence that they are primarily poor or old[73] when an examination of relevant databases shows they are primarily of moderate income and relatively young.[74] Furthermore, analysis of subprime mortgage databases indicates that the marketplace is efficient because subprime mortgage prices are closely correlated with more delinquencies and foreclosures.[75]

V. TAMING THE WILD WEST OF FINANCE

Litigation financing, such as the arrangements made by Ms. Rancman, is certainly within the category of subprime lending in that generally the borrowers do not qualify for traditional, prime credit, and the financing firms compensate in their rate of return for the risk of extending credit on the basis of only the borrower's interest in the outcome of a case in litigation.[76] Litigation financing does not, however, satisfy the general descriptions of predatory lending in that generally the borrowers are not being intimidated or fooled, and they have professionals to help them understand the terms of the financing. The reason these borrowers are in a different position from other subprime borrowers is that, almost by definition, people seeking funds to pay their living expenses while they await the outcome of their lawsuits, have lawyers who are already familiar with the circumstances in which their clients find themselves. These borrowers do not have to seek out legal help with their agreements with litigation financing firms; the lawyers they already have are going to be involved automatically, and they will have an ethical obligation to provide advice to their clients about the financing. The financing firm is going to contact the borrower's lawyer to make sure that it has all the information about the case so that it can assess its risk and so that the lawyer will keep it informed about the progress of the case and its outcome.

Nevertheless, merely having access to legal advice does not necessarily protect buyers from litigation financing firms that may be charging too much. Ms. Rancman, for example, rejected her lawyer's advice and contracted for funds at 180% and 280% rates. Perhaps she was making a rational decision that without the advanced funds she would have to accept the insurer's low settlement offer; with the funds, she would have the wherewithal to wait for a better offer and wind up with more money even after paying the financing company its agreed-upon rate. The problem is knowing whether the 180% and 280% is really too much.

It would be bad policy and unfair to poor plaintiffs with good cases to regulate litigation financing firms out of business. Consumer advocates have noted that very restrictive anti-predatory lending laws that set low limits on interest rates may, instead of protecting subprime borrowers, actually disadvantage them further by reducing their options.[77] However, there are a number of steps that Congress and state legislatures could take to protect choices available to plaintiffs with limited financial resources. These include amending the Truth in Landing Act, enacting reporting requirements, and encouraging competition.

A. Truth in Lending

The most obvious kind of regulation that would provide some protection for plaintiffs seeking litigation financing is a disclosure requirement. Some consumer advocates have dismissed disclosure requirements as merely providing a defense for unscrupulous lenders;[78] however, given that these plaintiffs/borrowers have legal counsel to advise them in using financial information, disclosure of easily comparable rates would certainly help them choose the litigation financing firm that offered the best deal.

The goals of the federal Truth in Lending Act (TILA) to strengthen competition among firms extending credit by the informed use of credit and to enable their customers to compare more easily the credit terms available[79] are certainly worthy goals for the regulation of the litigation financing industry. The industry, however, is not covered by TILA because litigation financing firms are not "creditors" within the meaning of the Act.[80] A "creditor" must *inter alia* regularly extend consumer credit.[81] "Credit" must involve the deferred payment of a "debt."[82] Generally, for a transfer of money to qualify as a "debt," the "repayment of the purported debt cannot be contingent upon a future event."[83] The repayment of money advanced by litigation financing firms is clearly contingent upon the plaintiff's success in the litigation. If the plaintiff loses, he or she keeps the money advanced by the litigation financing firm.

TILA could, however, be amended to include litigation financing firms. One way to do that would be to liberalize the meaning of "debt" to include contingent obligations when funds are advanced to support litigation. There is precedent for varying the definition of "debt" depending on the context in which it is used and, under some conditions, to define it broadly enough to include contingent obligations.[84] In addition, TILA's exemption for credit transactions exceeding $25,000[85] would have to be amended because there would be no justification for failing to provide financing information to plaintiffs with lawsuits valued high enough to justify financing firms extending more than that amount.

Inclusion in TILA protection would give plaintiffs/borrowers conspicuous disclosure of finance charges and annual percentage rates calculated in a uniform way.[86] Any advertising, including Internet ads, an important method for litigation financing firms appealing to customers, would have to set forth clearly and conspicuously the cost of the funds advanced.[87] Such disclosure would enable plaintiffs/borrowers to understand more easily what their cash advances would actually cost them if they did receive awards from their litigation, and it would enable them to shop around for the most favorable offer and to bargain for fee reductions.

B. Promoting Competition

Consumer advocates have argued that instead of regulating subprime lenders out of business, the government should to try to encourage traditional lenders to enter the subprime business.[88] One reason these advocates give for traditional lenders' reluctance to enter the subprime market is the unsavory reputation of the subprime industry.[89] That problem certainly exists in the litigation financing world. An example is Perry Walton who started the litigation finance business after he was convicted for extortionate collection of debt in 1997, ending his career in personal finance.[90] He then conducted seminars training people to set up litigation finance firms, reportedly charging more than $12,000 for a two-day program,[91] and boasted to reporters, "Pretty much everybody who got their start in the industry got it from me."[92] His involvement in a case heard in the U.S. District Court for the Western District of North Carolina[93] typifies the kind of behavior that has besmirched the entire industry.

In *Weaver, Bennett & Bland v. Speedy Bucks, Inc.*,[94] the Weaver law firm represented a client suing George Shinn, the owner of the Charlotte Hornets National Basketball Association team, but the client did not have the financial resources to fund the litigation.[95] Weaver received a solicitation from Walton's litigation financing business; the two met and signed a confidentiality agreement respecting the client's case.[96] According to Weaver's complaint, Weaver decided the financing arrangement was not legal under either North Carolina or South Carolina law (the two states involved) and declined to participate, whereupon Walton began dealing directly with the client unbeknownst to Weaver.[97] Walton entered into a contract with the client providing $200,000 to her in exchange for a percentage of her recovery in the suit with a minimum repayment of $600,000 if she were to win.[98] Weaver and the judge presiding over the case against Shinn were confused when the client was adamant about not accepting Shinn's settlement offer of $1,000,000 and not accepting anything less than $1,200,000.[99] Weaver explained that anything less than $1,200,000 would have resulted in a loss for the client because of her agreement with Walton.[100] The *Weaver* judge observed, "In a twist perhaps unique in law, a court loss resulting in no award of damages was better for the client than a million dollar settlement."[101] The client ultimately lost in a jury trial,[102] nevertheless keeping the $200,000 extended to her by the Walton firms. Weaver then sued the Walton firms for tortious interference with contract, fraud, and unfair and deceptive trade practices, winning a total of $521,225 in a jury trial.[103]

Representatives of litigation finance firms assert that Walton's situations are an anomaly; that unscrupulous dealers are not inherent to the industry; and that reputable firms deal directly and closely with plaintiffs/borrowers' attorneys.[104] Similar arguments are made by subprime lenders in automobile loan and home mortgage loan businesses as well as by advocates for low-income borrowers.[105]

One way to encourage honest litigation financing firms and to promote competition from more traditional lenders would be to collect information about the industry from the firms in it.[106] Reporting requirements would make data available so that assessments could be made about the profitability of the industry and its fair lending/advancing practices. In fact, some litigation financing companies are becoming more transparent in an effort to become more mainstream, and some traditional lenders are getting into the more risky business of supporting litigation.

C. Litigation Financing in the Mainstream

Although traditional banks are not extending funds to litigants making repayment contingent on the litigants' success in their cases, some have started opening lines of credit for lawyers supported by cases they have taken on a contingency fee basis.[107] Sunwest Bank of Tustin in Orange County, California has targeted law firms that take cases on a contingency basis because lawyers in southern California are well known for winning huge awards from juries.[108] Not only do these lawyers repay their lines of credit, but they put the proceeds of these cases in the bank, and they refer clients to the bank.[109] In addition, banks can charge contingency-fee lawyers higher rates because the business is riskier, banks can require personal guarantees or lawyers' personal residences as collateral, and the banks may require the lawyers to provide a monthly list of cases and expenses.[110] Other banks in Oregon, Tennessee, and Louisiana also view these lawyers as a unique opportunity to make money in the financing business because there is little competition.[111]

Litigation finance firms, on the other hand, are making attempts to institutionalize their industry, to improve their image by being more forthcoming on the rates they are charging, to keep those rates closer to credit card rates, and to become more involved in their communities.[112] For example, LawCash, a Brooklyn, New York-based company started in 2000 by two former health care industry financiers, has adopted lower interest rates and invites community endorsements.[113] Its annual interest rates ranged between sixteen and forty-eight percent when the average annual percentage rate charged by credit card companies was about fifteen percent.[114] In 2001 and 2002, it advanced more than $10 million to more than 1,300 people, and it lost its advance on only about four percent of the cases.[115] It will advance up to ten percent of its estimate of the eventual recovery in the case up to $100,000.[116] The director of the Brooklyn-based Association of Community Organizations for Reform Now (ACORN), a consumer advocacy group for low and moderate income families, started referring her organization's clients to LawCash.[117]

LawFunds LLC, a Salem, Massachusetts litigation finance firm, will deal only directly with the plaintiff/borrower's attorney.[118] That commitment eliminates the possibility of cases like *Weaver, Bennett & Bland, P.A. v. Speedy Bucks, Inc.* which diminish the reputation of the industry. Michael Blum, the chief executive officer of LawFinance Group, Inc., a San Francisco-based litigation finance firm, has developed guidelines for lawyers to evaluate litigation financing firms so that the lawyers can protect clients seeking outside funding while their lawsuits are pending.[119] His recommendations emphasize the importance of the

lawyer's diligent and loyal representation of the client in both the underlying litigation and the transactions with the litigation financing firm; the client's informed decision to enter into the litigation financing agreement after all financial terms have been disclosed; and the financing firm's distance from the conduct of the client's underlying case.[120]

There is little doubt that a litigation financing industry that acts professionally and ethically in attempting to earn a reasonable return for the risk it is undertaking, fills a need that has not been served by more traditional lenders. The industry can be improved by some regulation, but it would be unfortunate if the entire industry became the victim of a political movement of so-called tort reform that dwells on the outlier cases in which plaintiffs receive unwarranted windfalls but ignores the much more numerous situations where fairness and justice are absent because meritorious plaintiffs do not have the funds to sustain routine expenses as well as medical costs during the years that it may take to bring their cases to a final conclusion. One of the most famous customers of litigation financing was probably Abner Louima, the Haitian immigrant who brought a highly publicized case of police brutality against the New York City Police Department.[121] Three years after the start of his lawsuit, Louima still had not received any of the proceeds of his settlement, so to pay for living expenses, he obtained an advance of $20,000 from LawCash.[122] He agreed to repay the money plus interest of sixteen percent annually if and when he received the settlement.[123] Nine months later, after receiving a settlement of $8.75 million, he repaid LawCash.[124]

This case is not typical in either the size nor the certainty of the award, but that makes it a particularly good example of the useful service litigation finance firms provide to the low and moderate-income community. Louima, with no assets but his pending case, was not going to be able to receive a loan from a bank at a regulated rate, even though he was going to become in short order a multi-millionaire. In the meantime, while he waited for that settlement, he didn't have funds for living expenses. Getting the money from LawCash at a rather high rate of interest makes good financial and practical sense in his case. Who benefits if such a plaintiff does not have enough money for basic living expenses? Only the defendants benefit, whether or not they are in the right in the underlying case.

D. Litigation Financing and Tort Reform

Business defendants have been making great headway in recent years in getting the pendulum of tort law to swing in their direction.[125] Very cleverly, they have used the term "tort reform" to refer to their efforts to make it harder for tort plaintiffs to win cases and, when they do win, to receive awards that fully compensate them for their injuries and adequately punish defendants for egregious acts. Among their successes in various states have been limiting the potential medical malpractice liability of health care providers; eliminating joint and several liability; imposing caps on non-economic damages, particularly punitive damages; permitting structures settlements; and mandating alternative forms of dispute resolution.[126] Discouraging litigation financing is but one more example of business defendants attempts to "reform" tort law, that is, to rig the game so that plaintiffs have to forfeit before they have their full and fair day on the playing field.

There are many examples of business defendants using delaying tactics to the detriment of individual plaintiffs. *Scribner v. AIU Insurance Company*[127] is a very typical example in which the plaintiff suffered personal injuries when he was a passenger in a vehicle that was involved in an accident that occurred on March 20, 1987.[128] On August 20, 1989 the plaintiff offered to settle the case for the insurance policy limit, but AIU refused.[129] Later that month the plaintiff demanded that AIU proceed with arbitration on his claim for underinsured motorist coverage because the limits of all liability insurance policies had been exhausted without his being fully compensated, and again AIU refused.[130] In September 1989, the court ordered AIU to proceed with arbitration which did not commence until December 1991, and then "due to the defendants' delaying tactics" continued until September 1992. In October 1992, more than five and a half years after the accident, AIU finally paid the policy limit amount of $200,000.[131] The court noted that for years "the plaintiff requested repeatedly that his claim be processed diligently and promptly and that he be paid the amount of the policy limit. . . . The defendants . . . , however, refused to cooperate and delayed the resolution of the plaintiff's claim.[132] In a follow-up action against AIU for violating the Connecticut Unfair Trade Practices Act, the court awarded the plaintiff $450,000 in punitive damages because "the defendants' actions clearly indicate a reckless indifference to the rights of the plaintiff and an intentional and wanton violation of those rights."[133]

A plaintiff who suffered injuries like those of Scribner (which included a regression of a preexisting ataxia condition that caused blurred vision, uncontrollable shaking of his head, twitching and shaking of his arms and knees, and an adverse affect on his speech, eating, walking, sitting, and driving[134]) might not have been able to work and, therefore, not have been able to afford to pursue litigation for five and half years. Traditional lenders would not advance him the money he might need for living and medical expenses based on his interest in his lawsuit. Under those circumstances, the delaying tactics would work and would force him to accept an unfairly low offer from the defendant. Litigation finance firms can help such plaintiffs withstand these tactics.

VI. CONCLUSION

Litigation financing firms provide an option to plaintiffs with good cases but no financial resources. As in other subprime lending situations, such as automobile loans, home mortgage loans, and rent-to-own stores, there are lenders who take advantage of their plaintiffs/borrowers. The response to these unscrupulous individuals should be to require them to be transparent in their business dealings and to encourage competition so that customers who need their services will have more and better choices. To

regulate the litigation financing industry out of business, whether through legislation or court decisions, would merely substitute other businesses in positions of power, namely, defendants in lawsuits, who could take advantage of plaintiffs who cannot pay their living expenses or medical bills while they wait for the conclusion of their litigation.

Disallowing third party support for litigation on the grounds of champerty or usury does not serve the purpose for which those doctrines were created. No one is going to invest in a frivolous lawsuit because any money thus invested will be lost. Reputable firms will not insinuate themselves between clients and their lawyers. Third party support may prolong litigation, but that is a desirable effect if the alternative is to force plaintiffs without financial resources to accept any low but quick offer made by defendants. Us ury laws, rather than protecting plaintiffs/borrowers, limit their options if applied to litigation financing because traditional lenders will not invest in litigation; they judge the risk too great for the interest they are allowed to charge. Furthermore, unlike borrowers in other situations who may not be able to understand the financial agreements they are entering into, plaintiffs/borrowers have lawyers to advise them. They do not have to seek out a lawyer or pay an additional fee because the financing agreement is directly related to the case for which the lawyer has already been retained.

By leveling the playing field, litigation financing supports a tort system that deters negligence and encourages a corporate interest in safety.[135] It should be regulated to eliminate unscrupulous entrepreneurs, but not to eliminate the industry and the options it offers that are not otherwise available.

Footnotes

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1.Diane E. Lewis, *Accident Victims Get Money from "Advance Funders,"* Boston Globe, Oct. 2, 2003, at C1 (quoting Gerry Cohen, chairman of the Boston Bar Association Ethics Committee).

2.Michael Pollick, *Business & Money: Betting on the Verdict; Lawyers Advance Plaintiffs Money to Keep Lawsuits Going, in Hopes of Cashing in if a Suit Succeeds*, Sarasota Herald-Trib., Jan. 12, 2003, at D1 (quoting David Schechter, owner of ExpressLawsuitFunding.com.).

3.*Id.*

4.*Id.*

5.*Id.*

6.*Id.*

7.*See, e.g.,* Susan Lorde Martin, *Syndicated Lawsuits: Illegal Champerty or New Business Opportunity?*, 30 Am. Bus. L.J. 485, 485-88 (1992); Max Radin, *Maintenance by Champerty*, 24 Calif. L. Rev. 48, 51-52 (1935).

8.A.L.G., Note, *The Effect of Champerty in Contractual Liability*, 79 L.Q. Rev. 493, 494 (1963).

9.*See* Martin, *supra* note 7, at 490.

10.*See, e.g.,* Susan Lorde Martin, *Financing Plaintiffs' Lawsuits: an Increasingly Popular (and Legal) Business*, 33 U. Mich . J.L. Reform 57, 59-71 (2000).

11.Weller v. Jersey City H & P St. Ry. Co., 57 A. 730, 732 (N.J. Ch. 1904).

12.Saladini v. Righellis, 687 N.E.2d 1224, 1224 (Mass. 1997).

13.*See* Martin, *supra* note 10, at 72-79.

14.*See, e.g.,* Kraft v. Mason, 668 So. 2d 679 (Fla. Dist. Ct. App. 1996); Osprey, Inc. v. Cabana Ltd. Partnership, 532 S.E.2d 269, 382 (S.C. 2000).

15.*See, e.g.,* Susan Lorde Martin, *Financing Litigation On-Line: Usury and Other Obstacles*, 1 DePaul Bus. & Commercial L.J. 85, 89 (2002).

16.Christopher L. Peterson, *Truth, Understanding, and High-Cost Consumer Credit: The Historical Context of the Truth in Lending Act*, 55 Fl. L. Rev. 807, 820-21(2003).

17.*Id.* at 821.

18.*See* Martin, *supra* note 15, at 90 n.39 (listing state usury statutes and noting the repeal of the Idaho statute).

19.*See, e.g.*, Ives v. W.T. Grant Co., 522 F.2d 749, 762 (2d Cir. 1975) (Connecticut law); Dopp v. Yari, 927 F. Supp. 814, 820 (D.N.J. 1996) (New Jersey law); *In re* Maryvale Cnty. Hosp., Inc., 307 F. Supp. 304 (D. Ariz. 1969) (Arizona law).

20.Rancman v. Interim Settlement Funding Corp., 789 N.E.2d 217, 218 (Ohio 2003).

21.*Id.*

22.*Id.* at 218-19.

23.*Id.* at 219.

24.*Id.*

25.*Id.*

26.*Id.*

27.*Id.*

28.Rancman v. Interim Settlement Funding Corp., No. 20523, 2001 WL 1339487, at *3 (Ohio Ct. App. Oct. 31, 2001).

29.*Rancman*, 789 N.E.2d at 219.

30.*Id.*

31.*Id.*

32.Key v. Vattier, 1 Ohio 132 (1823).

33.Brown v. Ginn, 64 N.E. 123 (Ohio 1902).

34.Davy v. Fid. & Cas. Ins. Co., 85 N.E. 504 (Ohio 1908).

35.*Rancman*, 789 N.E.2d at 220.

36.*Id.*

37.In fact, in a concurrence one of the judges noted that because neither party addressed the issue of champerty, she would have preferred allowing them the opportunity to submit additional briefs on the subject. *Id.* at 221.

38.*Id.*

39.*Id.* at 220-21.

40.*Id.* at 220.

41.*Id.*

42.*Id.* at 221.

43.Rancman v. Interim Settlement Funding Corp., No. 20523, 2001 WL 1339487, at *3 (Ohio Ct. App. Oct. 31, 2001).

44.*Id.* at *1.

45.No. 01-A-435557-C, slip op. (Nev. Dist. Ct. Jan. 24, 2003).

46.*Id.* at 1.

47.*Id.*

48.*Id.* at 2.

49.*Id.* It should be noted that the more reputable litigation financing firms base their fees on the amount of money advanced, not on a percentage of the recovery. *See* Michael Blum, Standards and Practices for Attorneys with Clients Considering Litigation Funding 2 (2002) (Blum is CEO of LawFinance Group, Inc., a litigation financing firm in San Francisco) (unpublished manuscript, on file with author).

50.*Id.*

51.*Id.* at 5.

52.*Id.* at 3-5 (citing Schwartz v. Eliades, 113 Nev. 586 (1997); Lum v. Stinnett, 87 Nev. 402 (1971); Martinez v. Johnson, 61 Nev. 125 (1941)).

53.*See, e.g.*, Lynn Drysdale & Kathleen E. Keest, *The Two-Tiered Consumer Financial Services Marketplace: The Fringe Banking System and Its Challenge to Current Thinking about the Role of Usury Laws in Today's Society*, 51 S.C. L. Rev. 589 (200); Deborah Goldstein, Note, *Protecting Consumers from Predatory Lenders: Defining the Problem and Moving Towards Workable Solutions*, 35 Harv. C.R.-C.L. L. Rev. 225 (2000); Kathleen E. Keest, et al., *Interest Rate Regulation Developments: High-Cost Mortgages, Rent-to-Own Transactions, and Unconscionability*, 50 Bus. Law. 1081 (1995); Christopher L. Peterson, *Truth, Understanding, and High-Cost Consumer Credit: The Historical Context of the Truth in Lending Act*, 55 Fla. L. Rev. 807 (2003); Scott Andrew Schaaf, Note, *From Checks to Cash: The Regulation of the Payday Lending Industry*, 5 N.C. Banking Inst. 339 (2001); Kimm Tynan, Symposium: The Osceola, Note, *Pennsylvania Welcomes Predatory Lenders: Pennsylvania's Act 55 Preempts Philadelphia's Tough Ordinance but Provides Little Protection for Vulnerable Borrowers*, 34 Rutgers L.J. 37 (2003).

54.Tynan, *supra* note 53, at 840.

55.U.S. Dep't of Housing & Urban Development, *Curbing Predatory Home Mortgage Lending*, June 2000, updated Mar. 18, 2003, at 17, *available at* http://www.huduser.org/publications/hsgfin/curbing.html [*hereinafter* HUD].

56.Shimon A. Berger, Note, *Adding Insult to Injury: How In Re Venture Mortgage Fund Exposes the Inequitable Results of New York's Usury Remedies*, 29 Fordham Urban L.J. 2193, 2194 n.13 (2002); *see also* Freddie Mac, *Anti-Predatory Lending* (2004) (defining predatory lending as "any practice in which lenders try to fool or intimidate consumers into agreeing to assume loans that are ultimately unaffordable and do not meet industry standards"), *at* http://www.freddiemac.com/corporate/initiatives/protection/predlend.html.

57.*See* HUD, *supra* note 55.

58.*See* HUD, *supra* note 55.

59.*See* HUD, *supra* note 55, at 18.

60.*See* HUD, *supra* note 55, at 18.

61.*See* HUD, *supra* note 55, at 19.

62.In re Washer, 248 P. 1068, 1073 (Cal. App. 1926); *see also* Continental Ill. Nat'l Bank & Trust Co. of Chicago, 281 N.E.2d 346, 348 (Ill. App. 1972) ("obvious general purpose of the usury statute is to protect the necessitous borrower from an unscrupulous lender"); Schneider v. Phelps, 391 N.Y.S.2d 568, 572 (1977) (Judge Jasen writing for the court and referring to the purpose of usury laws "in almost all civilizations" "from time immemorial" as "recogniz[ing] that the crush of financial burdens causes people to agree to almost any conditions of the lender and to consent to even the most improvident loans").

63.Edward M. Gramlich, Federal Reserve Board Governor, *Remarks at the Texas Association of Bank Counsel 27th Annual Convention*, Oct. 9, 2003, *available at* http://www.federalreserve.gov/BoardDocs/Speeches/2003/20031009/default.htm.

64.Joseph A. Smith, Jr., *Financial Literacy, Regulation and Consumer Welfare*, 8 N.C. Banking Inst. 77, 80 (2004).

65.Anne Kim, Progressive Policy Institute, *Taken for a Ride: Subprime Lenders, Automobility, and the Working Poor* (Nov. 2002), at 1, *available at* www.ppionline.org.

66.*Id.* at 10

67.*Hearing on Subprime Lending Before the Subcomm. on Financial Inst. and Consumer Credit of the House Financial Serv. Comm.*, 108th Cong. (2004) (statement of Prof. Michael E. Staten, Professor of Management and Director of the Credit Research Center at the McDonough School of Business at Georgetown University) *available at* 2004 WL 740914 (F.D.C.H.) [hereinafter Staten].

68.*Joint Hearing on Subprime Lending: Defining the Market and Its Customers Before the Subcomm. on Financial Inst. and Consumer Credit and the Subcomm. on Housing and Community Opportunity of the House Financial Serv. Comm.*, 108th Cong. (2004) (statement of Eric Stein, Senior Vice President for the Center for Responsible Lending, a

non-profit research and public policy organization that is an affiliate fo Self-Help, a non-profit lender to borrowers who do not qualify for loans at traditional institutions) *available at* 2004WL740926 (F.D.C.H.) [hereinafter Stein].

69.Staten, *supra* note 67.

70.Staten, *supra* note 67.

71.Kim, *supra* note 65, at 10-11.

72.Kim, *supra* note 65, at 12.

73.*See Hearing on Predatory Lending Before the Senate Special Aging Comm.*, 108th Cong. (2004) (statement of Gavin Gee, Director of Idaho Dept. of Finance, asserting the harm that predatory lending does to the elderly and the "unbanked") *available at* 2004WL349616 (F.D.C.H.).

74.Staten, *supra* note 67.

75.Staten, *supra* note 67.

76.Litigation financing has also been sought by a variety of businesses. Large, well- capitalized firms have made the business decision that they would rather have a partner share the expenses of the litigation and receive money upfront from that partner in exchange for a share of the proceeds of the litigation which may not materialize for several years. Small firms without resources have attempted to syndicate their lawsuits so that they would have the money to pursue the litigation in exchange, again, for a share of the proceeds of the litigation, if there eventually are any. This article is focusing on consumers who are targeted by on-line litigation financing firms.

77.Anne Kim, Progressive Policy Institute, *Taken for a Ride: Subprime Lenders, Automobility, and the Working Poor* (Nov. 2002), at 2, *available at* www.ppionline.org.

78.*See, e.g.,* Stein, *supra* note 68.

79.15 U.S.C. § 1601(a) (2004).

80.15 U.S.C. § 1602(f) (2004).

81.*Id.*

82.15 U.S.C. § 1602(e) (2004).

83.*In Re Trumpeter*, 75 T.C.M. (CCH) 1653 (1998); *see also* Kizer v. Hanna, 255 Cal. Rptr. 412, 417 (1989) (en banc) (noting a definition of "debt" that holds that "a sum payable upon some contingency is not a debt until the contingency occurs"); 8 Mehrtens Law of Fed. Income Tax'n § 30:15 (2004).

> Every debt must be certain and in all events payable. Whenever it is uncertain whether anything will ever be demanded by virtue of the contract, it cannot be called a "debt," because debt is a liquidated demand, the payment of which is not dependent on the happening of any contingency.

Id.

84.*See, e.g.,* UMF Sys., Inc. V. Eltra Corp. 17 Cal. 3d 753, 756 (1976).

85.15 U.S.C. § 1603(3) (2004).

86.15 U.S.C. §§ 1606, 1632 (2004).

87.15 U.S.C. § 1663 (2004).

88.*See, e.g.,* Anne Kim, Progressive Policy Institute, *Taken for a Ride: Subprime Lenders, Automobility, and the Working Poor* (Nov. 2002), at 13, *available at* www.ppionline.org.

89.*See, e.g., id.*

90.Gary Young, *Two Setbacks for Lawsuit Financing but the Practice is Still Alive and Well*, Nat'l L.J., July 28, 2003, at 1.

91.Gary Young, *Sabotaged? Law Firm Sues Litigation-Finance Company in Case Involving Owner of Charlotte Hornets*, Miami Daily Bus. Rev., Jan. 4, 2002, at 11.

92.Young, *supra* note 90.

93.Weaver, Bennett & Bland, P.A. v. Speedy Bucks, Inc., 162 F. Supp. 2d 448 (W.D. N.C. 2001).

94.*Id.*

95.*Id.* at 450.

96.*Id.*

97.*Id.* at 451.

98.*Id.*

99.*Id.*

100.*Id.*

101.*Id.*

102.*Id.*

103.Gary Young, *Two Setbacks for Lawsuit Financing but the Practice is Still Alive and Well*, Nat'l L.J., July 28, 2003, at 1.

104.*Id.*

105.Anne Kim, Progressive Policy Institute, *Taken for a Ride: Subprime Lenders, Automobility, and the Working Poor* (Nov. 2002), at 13, *available at* www.ppionline.org.

106.*Compare id.* at 14 (making same argument for subprime automobile financing industry).

107.Katie Kuehner-Hebert, *A Few Banks Betting on Lawyers' Winning Ways*, Am. Banker, Jan. 3, 2002, at 6A.

108.*Id.*

109.*Id.*

110.*Id.*

111.*Id.*

112.Cristina Merrill, *Judgment Call: Firms that Lend to Personal-Injury Plaintiffs Take Steps to Improve Their Bad-Guy Image*, Crain's N.Y. Bus., Jan. 27, 2003, at 1.

113.*Id.*

114.*Id.*

115.*Id.*

116.Diane E. Lewis, *Accident Victims Get Money from "Advance Funders,"* Boston Globe, Oct. 2, 2003, at C1.

117.*Id.*

118.Gary Young, *Sabotaged? Law Firm Sues Litigation-Finance Company in Case Involving Owner of Charlotte Hornets*, Miami Daily Bus. Rev., Jan. 4, 2002, at 11.

119.Michael Blum, Standards and Practices for Attorneys with Clients Considering Litigation Funding (2002) (unpublished manuscript, on file with author).

120.*Id.*

121.Cristina Merrill, *Judgment Call: Firms that Lend to Personal-Injury Plaintiffs Take Steps to Improve Their Bad-Guy Image*, Crain's N.Y. Bus., Jan. 27, 2003, at 1.

122.*Id.*

123.*Id.*

124.*Id.*

125.*See, e.g.*, Timothy D. Howell, *So Long "Sweetheart"–State Farm Fire & Casualty Co. v. Gandy Swings the*

Pendulum Further to the Right as the Latest in a Line of Setbacks for Texas Plaintiffs, 29 St. Mary's L.J., 47, 49-50 (1997). *See generally* Note, *"Common Sense" Legislation: The Birth of Neoclassical Tort Reform*, 109 Harv. L. Rev., 1765 (1996).

126.Note, *supra* note 125, at 1768.

127.647 A.2d 48 (Conn. Super. Ct. 1994).

128.*Id.* at 49.

129.*Id.*

130.*Id.*

131.*Id.*

132.*Id.*

133.Scribner v. AIU Ins. Co., 1997 WL 793513, at *1 (Conn. Super. Ct. 1997).

134.Scribner v. AIU Ins. Co., 1997 WL 793515, at *2 (Conn. Super. Ct. 1998).

135.*See generally* Paul R. Sugarman & Valerie A. Yarashus, *If You Like Enron, You'll Love Tort Reform*, Boston Bar J., May/June 2002, at 26, 27.