THE LITIGATION FINANCING INDUSTRY: REGULATION TO PROTECT AND INFORM CONSUMERS

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Litigation financing companies ("LFCs") provide nonrecourse cash advances to plaintiffs in exchange for a portion of their lawsuits' potential future proceeds. While this arrangement allows individuals to continue to litigate without having to accept unjust settlement offers, desperate consumers are often forced to pay inequitable interest rates for the cases they finance. Because there is no absolute obligation to repay the LFC, the industry manages to avoid regulation under state interest rate ceilings for consumer loans. The few existing litigation financing laws do not restrict the interest rates that LFCs may charge, and even if some courts are willing to strike down egregiously unfair litigation financing agreements on a case-by-case basis, existing regulation fails to sufficiently protect consumers. On the other hand, overly strict interest rate ceilings on litigation financing agreements may foreclose the practice altogether. In order to preserve the benefits of litigation financing while protecting those who are desperate enough to need it, this Comment prescribes measures that would prevent predatory behavior and ensure reasonable profits for LFCs. Express statutory restrictions would prevent LFCs from reaping unreasonable profits, especially for the financing of lawsuits that practically guarantee sufficient settlements. States should also develop an online litigation financing "marketplace" that would offer updated business information, interest rate data, and customer reviews for each LFC. With transparent access to the industry, this centralized resource would promote consumer choice, expand

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access to litigation financing, and organically stimulate market competition.

INTRODUCTION

Imagine the following scenario: During a cross-country haul, a truck driver for a major freight company dozes off and veers into oncoming traffic. To avoid a direct collision, an uninsured single mother swerves into the guardrail and sustains severe injuries. She undergoes intensive surgery and must spend several months bedridden before she can work again. Her attorney is experienced, but it may take years to collect adequate compensation in court. With sufficient resources, she and her family could endure prolonged litigation against this wealthy defendant, whose insurers may strategically delay the case.[1] However, without family support or credit lines to help pay for medical bills, mortgage payments, and day-to-day expenses, she feels compelled to accept the

1. Defendants may purposefully hinder the progress of litigation in order to force cash-strapped plaintiffs to accept reduced settlements. *See* Susan Lorde Martin, *Litigation Financing: Another Subprime Industry That Has a Place in the United States Market*, 53 VILL. L. REV. 83, 102 (2008) [hereinafter Martin, *Another Subprime Industry*].

company's unreasonably low settlement offer.[2] Until the advent of litigation financing, she may have had no other option.[3]

Today, dozens of litigation financing companies (LFCs) provide cash advances to injured plaintiffs to cover pressing bills and living expenses.[4] In exchange for financial support during the pendency of a plaintiff's claim, the LFC receives a portion of the lawsuit's potential future proceeds.[5] Such an arrangement allows individuals to continue to litigate without the fear that financial need will force them to accept inequitable settlement offers.[6] Unlike traditional loans, which typically require unconditional repayment of the principal plus interest, litigation financing agreements are "nonrecourse."[7] The plaintiff only repays the LFC with the proceeds of her lawsuit, and owes nothing in the event of an unfavorable judgment.[8] Because there is no absolute obligation to repay the LFC, the industry typically manages to avoid regulation under state interest rate ceilings for consumer loans.[9]

Notwithstanding the nonrecourse structure of litigation financing agreements, LFCs are able to charge unreasonable interest rates based upon exaggerated risk projections.[10] Even

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2. *See id.*

3. Under the Model Rules of Professional Conduct, it is an ethical violation for a plaintiff's attorney to provide financial assistance to clients for living expenses. MODEL RULES OF PROF'L CONDUCT R. 1.8(e) (2009).

4. LFCs commonly market the practice of litigation financing as "litigation funding," "legal funding," or "lawsuit funding." *See* Lauren J. Grous, *Causes of Action for Sale: The New Trend of Legal Gambling*, 61 U. MIAMI L. REV. 203, 205–06 (2006-2007). According to one large LFC, over 60 percent of the financing it provides to plaintiffs is used to prevent foreclosure or eviction actions. *Facts About ALFA*, AM. LEGAL FIN. ASS'N, http://www.americanlegalfin.com/FactsAboutALFA.asp (last visited Feb. 9, 2012).

5. Grous, *supra* note 4, at 204. While smaller LFCs generally focus on personal injury lawsuits, larger LFCs can finance a wide variety of different claims including product liability, worker's compensation, patent infringement, breach of contract, and even civil rights suits. *See Pre Settlement Lawsuit Funding*, OASIS LEGAL FIN., http://www.oasislegal.com/oasis_lawsuit_funding_case_types (last visited Feb. 10, 2012); *Eligible Cases*, LAWCASH, http://www.lawcash.net/html/case-types.html (last visited Feb. 10, 2012).

6. Courtney R. Barksdale, *All That Glitters Isn't Gold: Analyzing the Costs and Benefits of Litigation Finance*, 26 REV. LITIG. 707, 734–35 (2007).

7. Cynthia Bulan, *A Small Question in the Big Statute: Does Section 402 of Sarbanes-Oxley Prohibit Defense Advancements?*, 39 CREIGHTON L. REV. 357, 374–77 (2005–2006).

8. Susan Lorde Martin, *The Litigation Financing Industry: The Wild West of Finance Should Be Tamed Not Outlawed*, 10 FORDHAM J. CORP. & FIN. L. 55, 55 (2004–2005) [hereinafter Martin, *The Wild West*].

9. Barksdale, *supra* note 6, at 723; Fausone v. U.S. Claims, Inc., 915 So. 2d 626, 630 (Fla. Dist. Ct. App. 2005).

10. Jason Lyon, *Revolution in Progress: Third-Party Funding of American*

where a plaintiff's case would almost certainly yield a definite and substantial settlement, an LFC can reap tremendous profits.[11] For example, a claim involving serious injuries and admitted wrongdoing practically ensures that the LFC will recover the principal plus significant interest. Finding that such arrangements virtually guarantee repayment to the LFC, some courts have voided or re-written individual litigation financing agreements as traditional loans subject to low interest rate ceilings.[12]

Within the past twenty years, litigation financing has developed from a fledgling practice into a prevalent, yet under-regulated, financial service.[13] The Rand Institute for Civil Justice described it as one of "the biggest and most influential trends in civil justice."[14] Despite industry growth and the unchecked potential for predatory LFC behavior, litigation financing remains completely unregulated in most states.[15] In the handful of states that have actually passed litigation financing laws, there are no caps on the interest rates that LFCs may charge.[16] Even if some courts are willing to strike down egregiously unfair litigation financing agreements on a case-by-case basis, existing regulation fails to sufficiently

Litigation, 58 UCLA L. REV. 571, 575 (2010–2011); *see also* Echeverria v. Estate of Lindner, No. 018666/2002, 2005 WL 1083704, at *8 (N.Y. App. Div. Mar. 2, 2005) ("[This] is a strict liability labor law case where the plaintiff is almost guaranteed to recover. There is low, if any risk. This is troubling considering the enormous profits that will be made from the rapidly accruing, extremely high interest rates they are charging.").

11. *See Echeverria*, 2005 WL 1083704, at *8.

12. *See id.*; Rancman v. Interim Settlement Funding Corp., 2001 Ohio App. LEXIS 4818, at *8 (Ohio Ct. App., Oct. 31, 2001); Lawsuit Fin., L.L.C. v. Curry, 683 N.W.2d 233, 239 (Mich. Ct. App. 2004). However, some courts acknowledge that the industry provides a benefit to consumers. *See, e.g.*, *Fausone*, 915 So. 2d at 630 ("A person who suffers a severe personal injury will often need money to care for herself and her family during the pendency of litigation. Lawsuits take time and come with few guarantees. Grocery stores and home mortgage lenders do not wait for payment merely because a person is unable to work due to an automobile accident or other injury.").

13. Martin, *Another Subprime Industry*, *supra* note 1, at 84–85. According to a recent *New York Times* article, LFCs advance a total of over $100 million per year to individual plaintiffs. Binyamin Appelbaum, *Lawsuit Loans Add New Risk for the Injured*, N.Y. TIMES (Jan. 16, 2011), http://www.nytimes.com/2011/01/17/business/17lawsuit.html?_r=3&emc=eta1 [hereinafter Appelbaum, *Lawsuit Loans*].

14. Laurel Terry, *Regulation Won't be Easy*, N.Y. TIMES (Nov. 15, 2010), http://www.nytimes.com/roomfordebate/2010/11/15/investing-in-someone-elses-lawsuit/regulating-the-industry-wont-be-easy.

15. Appelbaum, *Lawsuit Loans*, *supra* note 13.

16. *See*, *e.g.*, OHIO REV. CODE ANN. § 1349.55 (West 2008).

protect consumers.[17]

Conversely, some courts and regulators have imposed overly strict interest rate ceilings on litigation financing agreements. Most recently, the Denver District Court held that litigation financing agreements are loans subject to interest rate regulations under the state's usury laws.[18] While it is true that LFCs would be unable to set predatory rates if states regulated them as loans, cash-strapped plaintiffs would no longer have access to immediate funding if LFCs are "regulated out of business."[19] Due to the duration and unpredictability of litigation, steep operating costs, and absence of any interim payments, LFCs cannot finance lawsuits at traditional consumer loan rates.[20] If over-regulation cuts off access to litigation financing, cash-strapped plaintiffs will not have a fighting chance to keep their homes, provide for their families, and secure larger settlements from liable parties.[21]

In order to preserve the benefits of litigation financing while protecting those who are desperate enough to need it, this Comment prescribes measures that would prevent predatory behavior and ensure reasonable profits for LFCs. It is crucial for states to implement graduated interest rate ceilings for litigation financing agreements that are fairly

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17. *See infra* Part II.

18. Oasis Legal Fin. Grp. v. Suthers, No. 10CV8380, at 6 (D. Colo. Sept. 28, 2011). This decision was the result of the Colorado Attorney General's counterclaim to a lawsuit filed by Illinois-based Oasis Legal Finance and Brooklyn-based LawCash, two of the most influential and profitable LFCs in the nation. The companies alleged that Colorado was impermissibly categorizing litigation financing agreements as loans under the state's Uniform Consumer Credit Code. Ali McNally, *Colorado AG Questions Legitimacy of Pre-Settlement Legal Financing Companies*, L. WEEK COLO. (Jan. 11, 2011), http://www.lawweekonline.com/2011/01/colorado-ag-questions-legitimacy-of-pre-settlement-legal-financing-companies/.

19. Martin, *The Wild West*, *supra* note 8, at 68 ("It would be bad policy and unfair to poor plaintiffs with good cases to regulate litigation financing firms out of business. . . . [V]ery 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."). Indeed, the lawsuit prompted Oasis and LawCash to completely pull operations from Colorado rather than license themselves as state lenders subject to interest rate ceilings on consumer loans. *See* McNally, *supra* note 18.

20. Barksdale, *supra* note 6, at 710.

21. One commentator noted, "Although some funders have probably charged more than the risk they were undertaking required, emphasizing that aspect of the industry encourages onlookers to ignore the more important justice issue: how can poor plaintiffs collect what's owed them by wealthy defendants who wrongfully injured them?" Martin, *Another Subprime Industry*, *supra* note 1, at 84.

proportional to the LFC's risk.[22] Express statutory restrictions would prevent LFCs from reaping unreasonable profits, especially for the financing of lawsuits that practically guarantee sufficient settlements. In conjunction with equitable rate caps, states should also develop an online litigation financing "marketplace" that would offer updated business information, interest rate data, and customer reviews for each LFC. With transparent access to the industry, this centralized resource would promote consumer choice, expand access to litigation financing, and organically stimulate market competition.

Part I explains the typical litigation financing process, sheds light on the potential risks to consumers, and summarizes industry efforts to self-regulate LFC rates and standards of practice. Focusing on the putative risks assumed by the LFC in a litigation financing agreement, Part II examines the concept of "true contingencies" under traditional interpretations of usury law. Part II also discusses judicial decisions applying usury law to invalidate litigation financing agreements. Part III argues that existing regulations are either too lenient or too onerous. Concentrating on the recent Colorado decision, Part III first addresses overly aggressive efforts to regulate litigation financing agreements as traditional loans. Part III then outlines the watered-down state laws that legitimize the industry and provide some bedrock protections, but fail to actually restrict interest rates. Finally, Part IV recommends specific measures that states should adopt in order to protect and inform consumers, expand access to litigation financing, and stimulate market competition.

I. LFC BARGAINING AND LOBBYING POWER

An overview of the industry and the typical litigation financing process highlights the practice's current pitfalls. On top of deceptive marketing and burdensome applications, the consumer often has no meaningful options in the selection of an LFC. With no way to efficiently compare companies and rates, prices remain inflated and desperate consumers cannot make cost-effective judgments. The opaque nature of the practice is particularly distressing given its high cost, the plaintiff's

22. As discussed in Part IV, *infra*, an LFC's risk may be reasonably quantified through an objective analysis that considers individual case facts, the extent of the plaintiff's injuries, the defendant's resources, and several other factors.

urgent need for money, and the industry's vigorous opposition to regulation. Despite the benefit that LFCs provide, consumers will remain unfairly disadvantaged until states buck industry power and adopt measures to restrict rates and improve consumer choice. This Part addresses consumer perils in the LFC selection and application process, as well as the terms of the litigation financing agreement itself. This Part also describes the lobbying efforts of the American Legal Finance Association, which serves as the industry's trade association.

A. *The Litigation Financing Process*

The lack of meaningful choice in the litigation financing process disadvantages consumers, who are bombarded with advertisements with no means to effectively assess the options. Ratings and customer reviews are extremely rare, and consumers cannot efficiently access the interest rates that LFCs charge.[23] Most LFC websites do not publish their average rates or even advise consumers of the steep cost of litigation financing.[24] As a result, consumers are left to compare LFCs based only on the appearances and rhetoric of company websites. After seeing the same sugar-coated marketing pitches again and again, LFC websites appear almost indistinguishable.[25]

23. Very few LFCs publish approximate interest rates directly on their websites. *But see Rate Comparison for Lawsuit Loans*, FAIR RATE FUNDING, http://www.fairratefunding.com/pending-lawsuit-settlement-loans-litigation.html (last visited Feb. 10, 2010). Oasis phone representatives give approximate rate quotes based on the state where the caller is located, without any knowledge of the type of case or its specific facts. Oasis told this author during a phone call, for example, that he would have to repay $750 for a $500 advance after six months. The Oasis representative also noted that the company only communicates rate information over the phone.

24. Most LFCs do not explain the lack of published information on interest rates and fees. While Oasis does admit that litigation financing is "expensive," it does not provide its pricing information on its website "for competitive reasons." *Lawsuit Funding – What Does It Cost*, OASIS LEGAL FIN., http://www.oasislegal.com/legal_finance_services/lawsuit_funding_pricing (last visited Oct. 30, 2012). Oasis also discourages plaintiffs from signing on unless they "really have no other financial options." *The Benefits of Lawsuit Funding – Is It Right For You?*, OASIS LEGAL FIN., http://www.oasislegal.com/legal_finance_services/lawsuit_funding_benefits (last visited Oct. 14, 2012).

25. LFC websites typically employ short phrases in colored, bold, or capital letters,, such as "No Risk," "Cash in a Flash," "No Cost to Apply," or "Approval in as Little as 48 Hours." *See, e.g.*, *Frequently Asked Questions*, LEGAL FUNDS NOW, http://www.legalfundsnow.com/faq.htm (last visited Feb. 10, 2012); *Lawsuit Loan*

Consumers do not receive any precise information regarding interest rates, fees, and repayment schedules until their cases are approved for financing. To begin the process, a plaintiff submits basic information to the LFC about the nature of the claim, the types of injuries suffered, and the amount of cash needed.[26] The plaintiff must also authorize her attorney to release the attorney-client retainer agreement, proof of the defendant's insurance coverage, and complete case records to the LFC.[27] The LFC may then approve a certain amount of cash to advance to the plaintiff based on factors that determine the value and strength of her case, including the amount of damages; the severity and types of injuries; the defendant's level of culpability; the likelihood of a swift and favorable judgment; and the existence of any extra liens or medical bills that will ultimately have to be paid from the lawsuit's proceeds.[28] The application and case-review process for a single LFC, which may take days to complete and offers non-negotiable terms, can frustrate desperate consumers with an

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Approvals, MY LEGAL ADVANCE, http://www.mylegaladvance.com (last visited July 1, 2012); ADDISON PRE-SETTLEMENT FUNDING, http://www.addisonpsf.com/lawsuit_loans.html (last visited July 1, 2012); GLOBAL FINANCING JUST., http://www.glofin.com/index.php (last visited July 1, 2012). Of course, all LFCs focus their advertising on the nonrecourse nature of litigation financing agreements, which they describe as "investments" or "purchases" that are always contingent on a favorable settlement or judgment—"If you lose your case, you owe LawCash nothing." *See Plaintiff Lawsuit Funding*, LAWCASH, http://www.lawcash.net/html/plaintiffs.html (last visited Feb. 10, 2012).

26. Some applications also inquire as to whether the plaintiff missed time from work, received litigation financing from another LFC, ever filed for bankruptcy, or has any outstanding liens against her or the case. LFCs may charge a separate application fee to be added to the final repayment amount in the event that the plaintiff is approved for financing. *See Apply for a LawCash Advance*, LAWCASH, http://www.lawcash.net/html/application.html (last visited Feb. 10, 2012).

27. *See id.*

28. *Approval Factors*, OASIS LEGAL FIN., http://www.oasislegal.com/legal_finance_services/lawsuit_funding_approval_factors (last visited Feb. 10, 2012). According to Oasis, it usually limits the cash advance to 15 percent of the projected case value, i.e., the total amount of proceeds that the LFC determines that the plaintiff should expect to recover through a settlement or award. Depending on the claim and the LFC's available resources, the cash-advance amount may range from several hundred to hundreds of thousands of dollars. *See Benefits of Lawsuit Funding*, OASIS LEGAL FIN., http://www.oasislegal.com/legal_finance_services/lawsuit_funding_benefits (last visited Feb. 10, 2012). LawCash states that it will only advance up to 10 percent of the projected case value "so that the monthly usage fees do not reduce your settlement too much." *Plaintiff FAQs*, LAWCASH, http://www.lawcash.net/html/plaintiff-faqs.html (last visited Mar. 18, 2012). This may sound beneficent at first, but smaller cash advances mitigate the LFC's losses as well.

urgent need for money.[29]

Following approval, the LFC sends the litigation financing agreement to the plaintiff to sign.[30] The agreement sets forth the essential terms of the transaction: the plaintiff only repays the LFC using the proceeds of her lawsuit, and in the event of an unfavorable judgment, the plaintiff owes nothing.[31] The agreement may also include a repayment schedule that reflects increasing "payoff" amounts based on how long it takes to resolve the claim.[32] For an example of a litigation financing agreement, see Figure 1 below.

Figure 1. A sample "Purchase Agreement" from Oasis.[33]

Purchaser:	Oasis Legal Finance, LLC (Oasis)	
Seller:	Jerome Plaintiff	
Purchase Price:	**$1,234.00**	
Oasis Ownership Amount		
Payment Schedule	**Oasis Ownership Amount (Payoff Amount)**	
August 24, 2010 to February 23, 2011	$1,851.00	
February 24, 2011 to August 23, 2011	$2,036.10	
August 24, 2011 to November 23, 2011	$2,776.50	
November 24, 2011 to February 23, 2012	$3,085.00	
February 24, 2012 to August 23, 2012	$3,393.50	
August 24, 2012 to February 23, 2013	$4,010.50	
February 24, 2013 and thereafter	$4,319.00	
Fees Due at Repayment		
Case Servicing Fee every 6 months		$30.00
Subsequent Case Review for each additional funding		$20.00
Facsimile and Photocopying Costs per Funding		$25.00

Interest rates can vary according to the size of the cash advance and the facts of the particular lawsuit, and range from 2.5 percent to 15 percent, compounded monthly.[34] As shown in the example agreement above, LFCs may receive more than

29. *See, e.g.*, *Frequently Asked Questions*, OASIS LEGAL FIN., http://www.oasislegal.com/resources/frequently_asked_questions (last visited Feb. 10, 2012).

30. Grous, *supra* note 4, at 210. The litigation financing agreement may be titled "Purchase Agreement" or "Funding Agreement." As soon as the litigation financing agreement is signed and returned, the LFC wires the cash advance to the plaintiff, who gives nothing in return until and unless her lawsuit results in a settlement or award. The LFC usually reserves the plaintiff the option to apply for further financing before the resolution of the claim. *See id.*

31. Barksdale, *supra* note 6, at 713.

32. Under the few existing litigation financing laws, LFCs are obligated to include such repayment schedules. *See* OHIO REV. CODE ANN. § 1349.55 (2008); NEB. REV. STAT. § 35-3304 (2010); ME. REV. STAT. tit. 9-A, § 12-102 (2008).

33. The Colorado Attorney General used this sample Purchase Agreement in its case against Oasis. Oasis v. Suthers, No. 10CV8380 (Colo. Dist. Ct. Sept. 28, 2011).

34. Barksdale, *supra* note 6, at 710. As discussed in Part III.B, *infra*, some states prohibit monthly compounding and require a repayment schedule based on longer periods of time.

250 percent returns on their investments in plaintiffs' claims.[35] In some cases, the agreement may specify that the LFC is entitled to 100 percent of the proceeds in the event that the actual recovery is less than the scheduled payoff amount.[36] Some LFCs, on the other hand, state that attorney's fees must be paid before the LFC can collect from the proceeds.[37]

The benefit that LFCs provide is clear: without litigation financing to cover pressing bills and living expenses, negligent defendants may be able to force desperate plaintiffs to accept unjust settlement offers. Nevertheless, cash-strapped plaintiffs face considerable dangers in selecting an LFC and signing a litigation financing agreement. With no way to efficiently compare rates, consumers and their attorneys must spend hours delivering case documents and completing multiple applications in order to get the best deal.[38] Similarly, especially desperate consumers are likely to sign with the first LFC that agrees to finance their cases, even if significantly lower rates may be available elsewhere. These implications are especially worrisome where, as is the case in nearly all states, litigation financing is completely unregulated and there is no limit on the rates that LFCs may charge.[39] Even if most plaintiffs select large, relatively scrupulous companies, consumers are disadvantaged if only a handful of such LFCs dominate the industry and dictate national standards for litigation financing. In addition to actively opposing meaningful regulation, the existing LFC "oligopoly" may act to stifle competition and artificially inflate interest rates. The following section discusses the American Legal Finance Association (ALFA) and its powerful influence on the industry and lawmakers around the country.

35. Grous, *supra* note 4, at 211.

36. Fausone v. U.S. Claims, Inc., 915 So. 2d 626, 628 (Fla. Dist. Ct. App. 2005).

37. *See Frequently Asked Questions*, LAWCASH, http://www.lawcash.net/html/plaintiff-faqs.html (last visited Feb. 10, 2012).

38. Besides the fact that LFCs typically require plaintiffs to submit social security numbers, the application process is relatively intrusive and may even result in harassing behavior from companies that the plaintiff turns down. *See Complaint Review: Joe Simmons – PEACHTREE SETTLEMENT FUNDING*, RIPOFF REP., http://www.ripoffreport.com/cash-services/joe-simmons-peachtre/joe-simmons-peachtree-settleme-ez98b.htm (last visited Feb. 10, 2012).

39. *See* Appelbaum, *Lawsuit Loans*, *supra* note 13.

B. Industry Efforts to Self-Regulate Litigation Financing

ALFA serves as the litigation financing industry's national trade association and central lobbying power.[40] Established in 2004 and composed of twenty LFCs, the organization claims to be responsible for originating 90 percent of currently outstanding litigation financing agreements.[41] ALFA purports to "establish and maintain the highest ethical standards; . . . fair business practices; . . . [and] a legal and regulatory framework in individual states . . . that meet [sic] the needs and concerns of all parties."[42] Harvey Hirschfeld, ALFA's Chairman and a founder of LawCash, one of the largest LFCs in the country, characterizes litigation financing as "not for everyone, but it's there when you need it."[43] According to Hirschfeld, one of the association's main goals is to eliminate "companies in this industry [that are] charging very egregious agreements."[44] ALFA members pledge to not "intentionally advance . . . money in excess of the consumer's needs" or "over-fund a case in relation to [its] perceived value."[45]

Although ALFA's goals and practices are couched in terms of consumer interests, the association's main priority is to legitimize and self-regulate the $100 million industry.[46]

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40. *See* AM. LEGAL FIN. ASS'N, http://www.americanlegalfin.com (last visited Feb. 10, 2012).

41. *Facts About ALFA*, *supra* note 4. The ALFA website does not provide any information on the investors, officers, or employees of its LFC members.

42. *Id.*

43. Appelbaum, *Lawsuit Loans*, *supra* note 13.

44. *LawCash in the News*, LAWCASH, http://www.lawcash.net/html/news.html (last visited Feb. 10, 2012). Of course, some would say that LawCash and other ALFA members charge egregious rates for many high-value, low-risk lawsuits. In addition, the association's opposition to interest rate caps arguably serves to foster, not eliminate, predatory LFC behavior.

45. *Industry Best Practices – ALFA's Code of Conduct*, AM. LEGAL FIN. ASS'N, http://www.americanlegalfin.com/IndustryBestPractices.asp (last visited Feb. 10, 2012). Such "consumer-focused" methods further the interests of ALFA and its members, as well. Advancing too much money and then demanding repayment amounts that deplete plaintiffs' entire settlements would result in lawsuits, bad press, and fewer customers.

46. Benjamin Hallman & Caitlin Ginley, *Betting on Justice: States are Battleground in Drive To Regulate Lawsuit Funding*, NAT'L L. REV. (Feb. 2, 2011), http://www.natlawreview.com/article/betting-justice-states-are-battleground-drive-to-regulate-lawsuit-funding. As Lisa A. Rickard, president of the Institute for Legal Reform, maintains, "[The LFCs] are coming in under the guise of accepting regulation when in fact what they are trying to do is to legalize lawsuit lending and to explicitly exempt themselves [from] consumer lending requirements." Binyamin Appelbaum, *Lobby Battle Over Loans for Lawsuits*, N.Y. TIMES (Mar. 9, 2011), http://www.nytimes.com/2011/03/10/business/10lawsuits.html?pagewanted

According to the National Institute on Money in State Politics, this powerful group of LFCs, including Oasis and LawCash, has made over $200,000 in campaign contributions to state politicians.[47] The Center for Public Integrity asserts that LFCs have spent millions on lobbying efforts over the last several years.[48] ALFA successfully opposed industry-restricting bills in Texas and Maryland, and defeated Illinois legislation that would have created the first specialized interest rate caps for litigation financing agreements in the country.[49] Currently, the industry is fighting a bill in Arkansas that would completely prohibit litigation financing, as well as a Rhode Island bill that expressly subjects litigation financing to its usury laws.[50] In some states, the organization has also influenced the passage of lax regulatory schemes that fail to control interest rates or improve consumer choice.[51]

Despite ALFA's opposition to effective regulation of litigation financing, states should adopt comprehensive measures that ensure that the industry operates fairly and transparently. In nearly all states there is no limit on the rates and fees that LFCs may charge. With no reasonable interest rate caps and no way to efficiently compare companies, even relatively scrupulous ALFA-affiliated LFCs can continue to collect inequitable returns. However, even in cases that are practically guaranteed to result in repayment, litigation financing agreements should not qualify as true loans subject to overly strict interest rates. Focusing on the concept of "true contingencies" under traditional interpretations of usury law, the next Part addresses the legal form of litigation financing agreements, as well as the putative risks that LFCs assume through these arrangements.

=all [hereinafter Appelbaum, *Lobby Battle*].

47. Hallman & Ginley, *supra* note 46. The National Institute on Money in State Politics is "the only nonpartisan, nonprofit organization revealing the influence of campaign money on state-level elections and public policy in all 50 states." *See Mission & History*, NAT'L INST. ON MONEY IN ST. POLS., http://www.followthemoney.org/Institute/index.phtml (last visited July 1, 2012).

48. Hallman & Ginley, *supra* note 46. The Center for Public Integrity is "one of the country's oldest and largest nonpartisan, nonprofit investigative news organizations." *See About The Center for Public Integrity*, THE CENTER FOR PUB. INTEGRITY, http://www.iwatchnews.org/about/ (last visited July 1, 2012).

49. *See* Hallman & Ginley, *supra* note 46; Alberto Bernabe, *Illinois Legislature Rejects Proposal to Regulate Litigation Financing Companies*, PROF'L RESPONSIBILITY BLOG (Jan. 14, 2011), http://bernabepr.blogspot.com/2011/01/illinois-legislature-rejects-proposal.html.

50. *See* Appelbaum, *Lobby Battle*, *supra* note 46.

51. *See infra* Part III.B.

II. USURY LAW, RISK, AND "TRUE CONTINGENCIES"

Usury is "the charging of an illegal rate of interest as a condition to lending money."[52] State usury statutes regulate interest rates and finance charges for loans.[53] Interest rate ceilings are set according to the type of transaction; the size of the loan; the duration of the loan; the amount and type of security; the type of borrower (persons, organizations, corporations, etc.); and the type of lender (persons, pawnshops, banks, etc.).[54] These factors relate to the amount of risk involved in a particular loan transaction, with higher rates assigned to higher-risk loans.[55] By imposing interest rate caps that restrict the amount of risk that a lender is financially able to accept, usury statutes make it extremely difficult for lenders to give credit to impoverished high-risk consumers with no collateral.[56] Even so, one of the main purposes of usury statutes is to set reasonable rate and fee restrictions in order to protect consumers against "unfair practices by some suppliers of consumer credit."[57] For example, Colorado's Uniform Consumer Credit Code (UCCC) sets a maximum annual interest rate limit of 45 percent for consumer loans.[58]

Under most states' usury laws, litigation financing agreements do not qualify as true loans because the LFC is denied repayment in the event of an unfavorable judgment or insufficient settlement.[59] Courts typically require the following elements for a transaction to be usurious: (1) an agreement to lend money; (2) *the borrower's absolute obligation to repay*; (3) a greater compensation for making the loan than is allowed

52. BLACK'S LAW DICTIONARY 1685 (9th ed. 2009).

53. Martin, *Another Subprime Industry*, *supra* note 1, at 87; *see also* COLO. REV. STAT. § 5-1-102 (2011).

54. George Steven Swan, *The Economics of Usury and the Litigation Funding Industry:* Rancman v. Interim Settlement Funding Corp., 28 OKLA. CITY U. L. REV. 753, 769 (2003).

55. *See id.* at 774.

56. *See id.* at 774–75.

57. COLO. REV. STAT. § 5-1-102(2)(d) (2011). Another express purpose of the UCCC is "to permit and encourage the development of fair and economically sound consumer credit practices." *Id.* § 5-1-102(2)(e).

58. *Id.* § 5-12-103(1). Colorado Attorney General John Suthers alleged that Oasis and LawCash charged interest rates that ranged "from approximately 60 [percent] to 200 [percent], and possibly higher." Defs.' Mot. Partial Summ. J. & Prelim. Inj. at 30, Oasis v. Suthers, No. 10CV8380 (Colo. Dist. Ct. Mar. 17, 2011).

59. *See* Mariel Rodak, *It's About Time: A Systems Thinking Analysis of the Litigation Finance Industry and its Effect on Settlement*, 155 U. PA. L. REV. 503, 512–13 (2006).

under a usury statute; and (4) an intention to take more for the loan of the money than the law allows.[60]

Since litigation financing agreements result in repayment to the LFC only if the plaintiff receives a sufficient settlement or award, the second element requiring an "absolute obligation to repay" is not satisfied.[61] LFCs have generally been able to avoid violations and active regulation under usury laws due to this nonrecourse nature of litigation financing.[62]

Without express state regulation of nonrecourse litigation financing agreements, LFCs set their own industry rates and practices. For traditional financing practices that rely on collateral and monthly payments to secure loans, competition alone may be sufficient to maintain reasonable interest rates. However, the litigation financing industry requires much more than a laissez-faire approach given the strength of the LFC oligopoly and the vulnerability of injured and cash-strapped plaintiffs.

Moreover, despite its nonrecourse form, a litigation financing agreement may actually be a usurious loan if the chances are exceedingly high that the plaintiff will have to repay the LFC.[63] In a litigation financing agreement, denial of repayment to the LFC is conditioned on the occurrence of the "contingency," i.e., an unfavorable judgment or insufficient settlement.[64] Under traditional interpretations of usury law, a

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60. Martin, *The Wild West*, *supra* note 8, at 58–59 (emphasis added); Valliappan Ghirardo v. Antonioli, 883 P.2d 960, 965 (Cal. 1995); Holley v. Watts, 629 S.W.2d 694, 696 (Tex. 1982); Schauman v. Solmica Midwest, Inc., 168 N.W.2d 667, 669–70 (Minn. 1969); Valliappan v. Cruz, 917 So. 2d 257, 260 (Fla. Dist. Ct. App. 2005). Similarly, some courts state the second element as requiring "an understanding" that the money "must be" or "shall be" or "will be" repaid. *See* Liebergesell v. Evans, 613 P.2d 1170, 1174 (Wash. 1980); Swindell v. Fed. Nat'l Mortg. Ass'n, 409 S.E.2d 892, 895 (N.C. 1991).

61. Martin, *The Wild West*, *supra* note 8, at 59; *see also* RESTATEMENT (FIRST) OF CONTRACTS § 526 cmt. b (1932) (noting that an "essential element" of a usurious loan is that "the debt must be unconditionally repayable"); 9 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 20:18 (4th ed. 1993) (hereinafter WILLISTON) (stating that "under traditional usury statutes [that do not expressly encompass transactions other than loans], one of the requisites of a usurious loan is that it be absolutely, not contingently, repayable").

62. *See* Fausone v. U.S. Claims, Inc., 915 So. 2d 626, 630 (Fla. Dist. Ct. App. 2005); Anglo-Dutch Petroleum Int'l, Inc. v. Haskell, 193 S.W.3d 87, 96–97 (Tex. App. 2006).

63. *See* Echeverria v. Estate of Lindner, No. 018666/2002, 2005 WL 1083704, at *8 (N.Y. Sup. Ct. Mar. 5, 2005).

64. *See* RESTATEMENT (FIRST) OF CONTRACTS § 527 (1932). If a litigation financing agreement's contingency does occur, i.e., the plaintiff loses her lawsuit

true contingency that entails significant risk to the lender distinguishes a genuine nonrecourse transaction from a loan.[65] In other words, the possibility of the occurrence of the contingency event must be more than hypothetical.[66] Thus, in a litigation financing agreement, an unfavorable judgment or insufficient settlement cannot be so unlikely that repayment to the LFC is practically ensured.[67] Otherwise, the litigation financing agreement is not a truly "hazardous investment" that warrants higher interest rates than traditional loans.[68]

In contrast, ALFA argues the industry's view that an LFC's assumed risk in a litigation financing agreement always warrants relatively high interest rates.[69] In terms of risk, lawsuits are unpredictable due to procedural errors, attorney mistakes, and unanticipated details that can alter the entire structure—and final payout—of the case.[70] If plaintiffs abandon their claims, lose their cases, or receive smaller settlements than originally anticipated, LFCs lose money. Comparing litigation financing to venture capital investment, an LFC executive observed, "[i]t's as if your buddy came up to you and said, 'I'm starting a business, I need $25,000—and, by the way, you may never get your money back.'"[71] Even assuming that the defendant's liability is clear, damages awards often vary unexpectedly, and there is no absolute

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or receives an insufficient settlement, full or partial repayment is withheld. If the contingency does not occur and the plaintiff recovers a sufficient settlement or award, then the plaintiff must repay the LFC in the amount of the cash advance plus accrued interest.

65. *Id.*

66. *Id.*

67. *See Echeverria*, 2005 WL 1083704, at *8.

68. *See* WILLISTON, *supra* note 61, § 20:18 (noting that the policy behind the general exemption for nonrecourse transactions is based on the notion that when a lender "risks the principal with the chance of either getting a greater return than lawful interest or getting nothing if the contingent event fails to occur, there is no usury since the usury laws do not forbid the taking of business chances in the employment of money").

69. In addition to the risk of losing the cash advance in the event that the plaintiff's lawsuit is unsuccessful, ALFA claims that "the quality of service provided to both the client and the attorney, the actual risk involved in the expected repayment of the advance, the cost of capital used for the fundings, marketing and operating costs, and the length of time between funding a case to the repayment" are factors that necessitate higher rates for litigation financing agreements compared to traditional loans. *Frequently Asked Questions*, AM. LEGAL FIN. ASS'N, http://www.americanlegalfin.com/faq.asp (last visited Feb. 10, 2012).

70. *See* Barksdale, *supra* note 6, at 710.

71. *See* Appelbaum, *Lawsuit Loans*, *supra* note 13.

guarantee that the defendant will be able to satisfy a judgment when the lawsuit ends. Beyond the unpredictability of litigation, lawsuits can also take years to resolve. The lack of interim payments during the pendency of the plaintiff's claim—in addition to the absence of any secured collateral—increases the risk that the LFC will not see a profitable return on its investment.[72] An LFC must also have enough cash on hand to finance cases and cover steep operating costs: Teams of attorneys, underwriters, and insurance specialists must expertly and efficiently process hundreds of thousands of applications, many of which are presumably weak claims.[73] The industry argues that the combined value, costs, and risk of litigation financing justify higher interest rates than those allowed for traditional consumer loans.[74]

Even considering the practice's inherent risks and relatively high overhead costs, many litigation financing agreements do not require significantly higher rates than traditional consumer loans.[75] For cases that are very likely to result in a profitable return, LFCs still charge exorbitant rates based on exaggerated risk projections for repayments and losses.[76] For example, cases involving strict liability, admitted wrongdoing, and obvious gross negligence nearly ensure definite and sufficient settlements.[77] To the extent that other objective case factors are present, such as severe injuries, multiple eyewitnesses, and significant property damage, consumers deserve discounted rates. As one court opined:

> A person who is the victim of an accident should not be further victimized by loan companies charging interest rates that are higher than the risks associated with the

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72. *See* Barksdale, *supra* note 6, at 710.

73. *See id.* at 729–30. ALFA claims that the average cost for an LFC to do business is 30 percent of the total financing it offers per year. *FAQs*, AM. LEGAL. FIN. ASS'N, http://www.americanlegalfin.com/alfasite2/faqs.asp (last visited Feb. 10, 2012). The association also states that the rates each LFC can charge largely depend on how the company can manage its marketing and operating costs. *Frequently Asked Questions*, *supra* note 69. Without LFC disclosures of business information, one can only assume that these operating costs are exclusively passed on to those plaintiffs that the LFC decides to finance, since LFCs do not charge application fees up front.

74. *Frequently Asked Questions*, *supra* note 69.

75. *See* Julia H. McLaughlin, *Litigation Funding: Charting a Legal and Ethical Course*, 31 VT. L. REV. 615, 637–38 (2007).

76. *See id.*

77. *See id.* at 637.

> transaction . . . . [A] company that only loaned money when it was secured by high-grade personal injury claims would seem to be able to charge a lower interest rate than some of the rates described in this opinion, even when the arrangement is . . . nonrecourse.[78]

Whether or not extremely low-risk cases undermine the legitimacy of their nonrecourse form, litigation financing agreements should return profits that reasonably match the LFC's risk and added costs, even if this means that rates must exceed the current limits for consumer loans.[79]

Without industry regulation, LFCs will continue to reap unfair profits from consumers due to their expertise in risk reduction and bargaining advantage over desperate plaintiffs. In order to exclusively finance promising cases at the outset, LFCs reject approximately 70 percent of the applications they receive.[80] Among the selected cases that the LFC expects to turn a profit, LFCs can demand equally high rates for cases involving disparate levels of risk.[81] An LFC's "diversified portfolio" of pending claims also spreads some of the risks that are associated with each lawsuit as an individual claim.[82] Moreover, with no efficient way for consumers to compare companies and rates, competition is stymied and interest rates remain inflated. In defense, LFCs proclaim that they still lose money on five to twenty percent of the cases they finance.[83] Nevertheless, there is currently no way to confirm this data because LFCs are not required to disclose business and financial information.[84] This information must be made available so that regulators can cap interest rates based on the level of risk that LFCs actually face.

Some cases demonstrate that courts are willing to strike down unfair litigation financing agreements in a case-by-case manner.[85] In *Rancman v. Interim Settlement Funding Corp.*,

78. Fausone v. U.S. Claims, Inc., 915 So. 2d 626, 630 (Fla. Dist. Ct. App 2005).

79. From this point forward, the LFC's "risk" includes its operating costs.

80. Appelbaum, *Lawsuit Loans*, *supra* note 13. Out of 250,000 applications in recent years, Oasis stated that it had approved about 80,000. *Id.*

81. *Id.*

82. *See* George Steven Swan, *Economics and the Litigation Funding Industry: How Much Justice Can You Afford?*, 35 NEW ENG. L. REV. 805, 829–31 (2001).

83. Appelbaum, *Lawsuit Loans*, *supra* note 13.

84. *See* Martin, *Another Subprime Industry*, *supra* note 1, at 103.

85. Courts are less likely to override the express terms of litigation financing agreements when the parties are not individual plaintiffs, but sophisticated parties such as plaintiffs' attorneys. *See* Kelly, Grossman & Flanagan, LLP v.

the Ohio Court of Appeals found that a litigation financing agreement constituted a usurious loan because the associated risk was too low to qualify as a true contingency.[86] The court concluded that the LFC's contract was for a loan "because no real probability existed that non-payment would occur" based on the facts of the plaintiff's underlying case.[87] Trial testimony revealed that there was an extremely low level of risk of the plaintiff's non-recovery in light of several factors, including a skilled and experienced attorney; no apparent liability on the plaintiff's part; extensive property damage to the plaintiff's vehicle; "bright blood" injuries;[88] significant medical bills; and LFC access to jury verdict databases containing records of awards for comparable claims.[89] As the court reasoned, "[t]he payment of a sum is considered 'repayable absolutely' if non-payment of the amount is 'so improbable as to convince the court or jury that there was no real hazard.'"[90] Although it was the most hotly contested issue on the second appeal, the Ohio Supreme Court did not address the "threshold level of risk" necessary for a litigation financing agreement to constitute a contingency-based investment rather than a loan.[91] Instead, the court voided the litigation financing agreement on grounds that were later abrogated by statute.[92]

Similarly, in *Echeverria v. Estate of Lindner*, a New York trial court re-wrote a LawCash litigation financing agreement as a loan with a 16 percent annual interest rate, the highest

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Quick Cash, Inc., No. 04283-2011, 2012 N.Y. Misc. 1460, at *13 (N.Y. Sup. Ct. Mar. 29, 2012) ("The Court finds that the language in the contracts was not ambiguous, and the intent of the parties is clear, as demonstrated by the plaintiffs' express acknowledgment, as sophisticated attorneys, in each contract that a nonrecourse agreement for a cash advance was entered into and not a loan.").

86. Rancman v. Interim Settlement Funding Corp., No. 20523, 2001 Ohio App. LEXIS 4818, at *8 (Ohio Ct. App. Oct. 31, 2001).

87. *Id.* at *8. In *Rancman*, the plaintiff, who ultimately recovered $100,000 from her personal injury suit against a drunk driver, filed suit against two LFCs for unfair, deceptive, or unconscionable practices. The litigation financing agreements that she entered into with the LFCs charged 280 percent and 180 percent annual interest, respectively. *Id.* at *2.

88. The court does not explain what this term means.

89. *Rancman*, 2001 Ohio App. LEXIS 4818, at *7–8.

90. *Id.* at *6 (citation omitted).

91. Rancman v. Interim Settlement Funding Corp., 789 N.E.2d 217, 219 (Ohio 2003).

92. *See id.* Due to the influence of ALFA lobbying efforts, the Ohio legislature passed a statute five years later that legitimizes, yet barely regulates, the litigation financing industry. *See* OHIO REV. CODE ANN. § 1349.55 (2008).

legal rate under state law.[93] While conceding that litigation financing agreements "do allow the plaintiffs to proceed with lawsuits that they ordinarily would not have the resources to bring," the court focused on the "very low probability that judgment would not be in favor of the plaintiff:"[94]

> The court finds that LawCash is lending money at usurious rates. Also, that it is ludicrous to consider this transaction anything else but a loan unless the court was to consider it legalized gambling. Is it a gamble to loan/invest money to a plaintiff in a[n] . . . action where there is *strict liability*? I think not . . . . [T]herefore, it is a loan, not an investment with great risk. If it is a loan, then the interest rate charged is usurious and the court could vitiate the agreement.[95]

Likewise, in *Lawsuit Financial, L.L.C. v. Curry*, the Michigan Court of Appeals voided a litigation financing agreement where the defendant in the underlying case had admitted to full liability to the extent of $27 million in damages.[96] Because the plaintiff was practically guaranteed a tremendous recovery, the court found that the litigation financing constituted a usurious loan.[97]

While some courts are willing to invalidate egregious litigation financing agreements, ad hoc court action is not sufficient to fully protect and inform consumers. Whether or not some cases practically guarantee repayment to the LFC, litigation financing agreements require separate regulatory regimes because they involve higher levels of risk and greater overhead costs than traditional loans. Even relatively low-risk suits like strict liability cases always hazard some possibility of a total or partial loss for the LFC, but they do deserve highly discounted rates that are fairly proportional to the LFC's risk. Once LFCs are required to disclose business and financial information, states can fairly cap interest rates according to an objective case-risk calculus. Graduated interest rate ceilings would fully protect consumers while ensuring that LFCs receive reasonable profits that allow them to stay in business. As Part III explains, such action is necessary because the few

93. 2005 N.Y. Misc. LEXIS 894, at *24 (N.Y. Sup. Ct. 2005).
94. *Id.* at *21-22.
95. *Id.* at *23–24 (emphasis added).
96. 683 N.W.2d 233, 239–40 (Mich. Ct. App. 2004).
97. *See id.* at 239.

existing forms of regulation do not adequately balance consumer interests.

III. EXISTING REGULATION OF LITIGATION FINANCING FAILS TO EMPOWER AND PROTECT CONSUMERS

Given the growing demand for litigation financing, it is dismaying that the industry is completely unregulated in most states. Some courts may be willing to strike down individual litigation financing agreements, but without comprehensive state regulation, LFCs are still able to set unreasonable rates. Several courts and state legislatures have attempted to control industry practices, but such efforts either "over-regulate" or "under-regulate" LFCs to the disadvantage of consumers. "Over-regulation" occurs where courts and regulators subject all litigation financing agreements to exceedingly strict rate restrictions under state usury laws. Conversely, "under-regulation" occurs where states create some information disclosure rules but fail to control interest rates or improve consumer choice.[98] Because "over-regulation" may cut off the availability of litigation financing and "under-regulation" allows LFCs to continue to charge unreasonable rates, neither measure adequately empowers and protects consumers. The following sections explore in greater detail the shortcomings and consequences of these regulatory schemes.

A. Over-Regulation: Equating Litigation Financing Agreements With Traditional Loans Hurts Consumers

Only a few courts and regulators have classified all litigation financing agreements as loans, regardless of risk. In addition to regulators in Maryland and Louisiana, courts in Colorado and North Carolina have concluded that LFCs issue usurious loans. As discussed, most litigation financing agreements require higher interest rates that are proportional to the LFC's risk. If exceedingly low interest rate caps severely limit access to litigation financing, desperate plaintiffs may not be able to save their homes, provide for their families, and fight

98. *See, e.g.*, OHIO REV. CODE ANN. § 1349.55 (2008); *see also* Hallman & Ginley, *supra* note 46 ("In recent years, the industry and its allies have focused most of their efforts on supporting bills . . . that would establish licensing and disclosure rules, but also block caps on the interest rates the lenders can charge.").

for more equitable settlements. As Jim Miller, an attorney representing Oasis and LawCash, stated in an interview, "[t]hese are people that sell part of their lawsuit because they have compelling needs . . . . They don't have access to the banks or relatives to loan them money. To take [access to litigation financing] out of the Colorado judicial system kills consumers."[99]

In 2010, Colorado Attorney General John Suthers filed a counterclaim against Oasis and LawCash for engaging in usurious lending under Colorado's usury law, the UCCC.[100] The Attorney General's office argued that pursuant to *State* ex rel. *Salazar v. The Cash Now Store, Inc.*, litigation financing agreements are loans regardless of their nonrecourse form.[101] In *Cash Now*, the Colorado Supreme Court held that immediate cash advances issued in exchange for an individual's future tax refunds are UCCC-covered loans.[102] These "tax-based" loans would typically be fifty to sixty percent smaller than the anticipated tax refunds, but were given under the condition that the consumer would owe the company nothing further unless the actual refund happened to be less than the anticipated refund.[103] Noting that "Colorado's UCCC is intended to be liberally construed to promote its underlying purposes and policies," the court reasoned that a loan does not require an unconditional obligation to repay the lender.[104] Instead, a loan is created whenever "a creditor creates debt by advancing money to the debtor."[105]

Under *Cash Now*, litigation financing agreements should be excluded from the UCCC's purview, not subjected to it. The court indicated that a true loan requires repayment to the

99. McNally, *supra* note 18.

100. The counterclaim was the result of a lawsuit filed by Oasis and LawCash seeking judgment against Colorado for impermissibly regulating them under the UCCC. *See id.* According to Suthers, Oasis and LawCash charged interest rates that ranged "from approximately 60 [percent] to 200 [percent], and possibly higher." *See* Defs.' Mot. Partial Summ. J. & Prelim. Inj., *supra* note 58, at 30. Colorado's UCCC, by contrast, allows a maximum interest rate of 45 percent for loans. COLO. REV. STAT. § 5-12-103(1).

101. *See* Defs.' Mot. Partial Summ. J. & Prelim. Inj., *supra* note 58, at 3.

102. State *ex rel.* Salazar v. The Cash Now Store, Inc., 31 P.3d 161, 167 (Colo. 2001).

103. *See id.*

104. *Id.* at 166 (referencing COLO. REV. STAT. § 5-1-102(2)(d), which states that one of the express purposes of Colorado's UCCC is to protect consumers against "unfair practices by some suppliers of consumer credit, having due regard for the interests of legitimate and scrupulous creditors").

105. *Cash Now*, 31 P.3d at 166.

lender whether or not the lender's interest in the transaction has value.[106] The tax-based advances were undoubtedly loans because the consumer was obligated to repay the lender the full amount owed *in all cases*.[107] If the tax refund turned out to be lower than anticipated, the borrower would still have to pay off the remaining debt with other cash or assets.[108] In contrast, nonrecourse litigation financing agreements result in a direct loss to the LFC in the event of an unfavorable judgment or insufficient settlement. Because the LFC can collect repayment only from the lawsuit's proceeds, a plaintiff's case may bear diminished value—if not an absolute loss—for the LFC.

Nevertheless, the Denver District Court agreed with the Attorney General that litigation financing agreements are loans subject to UCCC regulation.[109] In its order, the court did not give much weight to the nonrecourse nature of litigation financing, but instead applied *Cash Now*'s broad holding that a loan is created whenever a "creditor creates debt by advancing money to a debtor."[110] Without acknowledging the clear differences between litigation financing agreements and the tax-based loans, the court simply noted that *Cash Now* "clearly demonstrates the Supreme Court's intention that recourse is not a prerequisite to applying the term 'loan' under the UCCC."[111] The court admitted that "there is risk involved" in litigation financing due to "potential instances where the [LFCs] cannot . . . recover against the individual plaintiffs they have given funds to."[112] Despite the potential for over-regulation, the court held that the risk of loss to the LFC does not differentiate litigation financing from loans that impose an

106. *Id.* at 167 ("[E]ven the lender 'demonstrates that it does not view the refund as a chose in action because the borrower owes it a sum of money whether the refund . . . is valuable to [the lender] or not.'" (quoting Income Tax Buyers, Inc. v. Hamm, No. 91-CP-40-3193, 1992 WL 12092431 (S.C. Ct. C.P., Jan. 14, 1992)).

107. In most cases, where the actual refund was equal or greater to the anticipated refund, Cash Now would be repaid through the tax refund, while in the remaining cases where the actual refund happened to be less than the anticipated refund, the consumer was "required to pay Cash Now for the deficiency" in addition to the insufficient tax refund. *See id.* at 163–64.

108. *See id.*

109. The court declined to grant an injunction based on the pleadings alone. Oasis v. Suthers, No. 10CV8380, slip op. at 7 (Colo. Dist. Ct. Sept. 28, 2011). The decision is currently under appeal.

110. *See id.* at 5.

111. *See id.*

112. *See id.*at 5–6.

unconditional obligation to repay the lender.[113]

In addition to Colorado courts, courts and regulators in other states have applied usury law restrictions to litigation financing agreements. In response to an opinion request, Louisiana's Attorney General classified litigation financing as loans even though the obligation to repay the LFC "may be conditioned on an uncertain event."[114] Similarly, the Maryland Commissioner of Financial Regulation recently issued cease and desist orders against several LFCs for engaging in usurious lending.[115] In 2008, the North Carolina Court of Appeals held that litigation financing agreements are usurious transactions.[116] Although the court recognized that true loans impose an unconditional obligation to repay the lender, North Carolina's usury law expressly encompasses "advances" as well as loans.[117] Noting that advances under North Carolina law require merely an "expectation" of repayment, the court concluded that litigation financing agreements are subject to the statute's rate caps.[118]

According to these courts and regulators, basic consumer protection purposes should trump traditional interpretations of usury law. As Attorney General Suthers described litigation financing, "It looks like a loan and smells like a loan and we believe that these are, in fact, high-cost loans . . . . I can see a legitimate role for it, but that doesn't mean that they shouldn't be subject to regulation."[119] Suthers is correct to say that states should regulate LFCs, but from a practical standpoint that recognizes the benefit of litigation financing, usury laws are not the proper vehicles for industry control. While states must protect consumers against predatory lending, it is likely that overly strict rate caps impede access to litigation financing.

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113. *See id.* at 6 ("While the [LFCs'] transactions . . . may be contingent upon receipt of proceeds by the plaintiff funded, or may never be collected due to abandonment or otherwise, the transactions create debt under the plain language of the UCCC and the definitions observed by the Court.").

114. *See* La. Op. Att'y Gen. No. 01-160, 2001 WL 1398739 (La.A.G. Oct. 11, 2001).

115. *See, e.g.*, *In re* Nat. Lawsuit Funding, LLC, No. CFR-FY2012-128, at 2 (Md. Comm'r of Fin. Reg., Jan. 1, 2012), *available at* http://www.dllr.state.md.us/finance/consumers/pdf/nationallawfundingc&d.pdf.

116. Odell v. Legal Bucks, LLC, 665 S.E.2d 767, 781 (N.C. Ct. App. 2008).

117. *Id.* at 776.

118. *See id.* at 777 (stating that while the LFC's "obligation to repay the principal was conditional on [the plaintiff's] recovery, [the LFC] certainly made the advance 'in expectation of reimbursement.'").

119. Appelbaum, *Lawsuit Loans*, *supra* note 13.

Rather than give the upper hand to negligent defendants, states should pass measures that protect consumers while leaving them free to pursue litigation financing at a fair price. Such a regulatory model would build on existing state regulations—described in the next section—that introduce some basic consumer protections but fail to restrict interest rates.

B. Under-Regulation: Weak Statutes Legitimize the Industry but Fail to Adequately Protect Consumers

In some states, the litigation financing industry has successfully negotiated the implementation of rules that create basic disclosure and pricing restrictions, but do not limit interest rates. In 2005, the newly-established ALFA forged a non-legislative "Assurance" with the New York Attorney General.[120] Under the Assurance, the nine original ALFA members promised to draft litigation financing agreements that disclose annual interest rates, itemize and describe any one-time fees, and include thirty-six-month "repayment schedules" broken down into six-month intervals.[121] The LFCs also pledged to allow consumers a five-day cooling off period to terminate the agreement, as well as to conspicuously advise consumers to consult legal representation prior to signing.[122]

Although this non-legislative measure established some information disclosure guidelines, it does not sufficiently protect consumers. Most conspicuously, it does nothing to control the dozens of LFCs that have financed lawsuits in the state; the Assurance only indirectly influences the practices of large ALFA-affiliated LFCs that were benefitted tremendously by the legitimizing effects of this agreement.[123] The Assurance

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120. The agreement, entitled "Assurance of Discontinuance Pursuant to Executive Law §63(15)," *available at* http://www.americanlegalfin.com/alfasite2/documents/ALFAAgreementWithAttorneyGeneral.pdf, was entered into in order to address the Attorney General's concerns regarding LFC practices. *See* McLaughlin, *supra* note 75, at 654.

121. *See id.* The "repayment schedule" outlines the increasing time-based payoff amounts equal to principal plus accumulated interest. *See* the figure on p. 507, *supra*.

122. *See* Assurance of Discontinuance Pursuant to Executive Law § 63(15), Eliot Spitzer, Att'y Gen. of the State of New York; Bureau of Consumer Frauds and Protection, Feb. 17, 2005, *available at* http://www.americanlegalfin.com/alfasite2/documents/ALFAAgreementWithAttorneyGeneral.pdf

123. Because the Assurance implicitly validated the practice of litigation financing, the LFC signatories were virtually assured of the enforceability of their

also fails to restrict unjustifiably high interest rates for low-risk cases, and does nothing to improve the consumer's extremely limited ability to make educated, balanced choices in the selection of an LFC. In *Echeverria*, the New York Superior Court expressly criticized the Assurance for permitting the Attorney General to tacitly endorse litigation financing in its current form without the consent of the state legislature.[124]

Although the few existing litigation financing statutes are more broadly enforceable against LFCs than the New York Assurance, they too lack the force to fully protect consumers against predatory behavior. In 2007, ALFA worked with state legislators in Maine to pass a law that creates some price restrictions and addresses contract information disclosure, but does not mandate interest rate ceilings.[125] The statute, which represented the first state effort to legitimize and oversee the litigation financing industry, defines "legal funding" without characterizing the transactions as loans.[126] Like the New York Assurance, the statute requires litigation financing agreements to itemize all fees, specify the annual percentage fee or rate of return, set forth a forty-two-month long repayment plan divided into six-month increments, and give consumers a five-day period to void the contract.[127] In addition, it requires litigation financing agreements to include a statement from the plaintiff's attorney providing that he or she has reviewed the contract and discussed its terms with the client, including the repayment schedule.[128]

Besides the provisions relating to information disclosure, Maine's litigation financing statute also contains some pricing restrictions. The statute stipulates that LFCs may not charge additional interest payments after forty-two months, which ensures that ultimate repayment amounts will not balloon to unexpected proportions if claims take years to resolve.[129] The law also prohibits LFCs from assessing interest more

litigation financing agreements, and were protected from AG challenges in court as long as they complied with its terms.

124. Echeverria v. Estate of Lindner, No. 018666/2002, 2005 WL 1083704, at *7 (N.Y. Sup. Ct. 2005). New York's legislature has yet to address the issue of litigation financing, but ALFA persuaded legislators to introduce a watered-down litigation financing bill in 2011. *See* Appelbaum, *Lobby Battle*, *supra* note 46.

125. *See Facts About ALFA*, *supra* note 4; ME. REV. STAT. ANN. tit. 9-A, § 12-102 (2008).

126. ME. REV. STAT. ANN. tit. 9-A, § 12-102 (2008).

127. *Id.* § 12-104.

128. *Id.*

129. *See id.* § 12-105.

frequently than semi-annually.[130] Moreover, LFCs may no longer compute the annual percentage fee or rate of return on any amounts not "actually received and retained by a consumer" (e.g., one-time application, review, and brokering fees).[131]

A few months after Maine enacted this legislation, Ohio enacted a nearly identical law that abrogated the earlier *Rancman* ruling.[132] Nebraska's matching litigation financing statute, which limits the interest charges assessment period to thirty-six months and prohibits LFCs from paying commission to attorneys for case referrals, went into effect in 2010.[133] Since then, ALFA has introduced similar bills in at least five other states: Alabama, Indiana, Kentucky, New York, and Maryland.[134]

Although these laws represent a promising trend toward legitimizing litigation financing, they do not adequately shield consumers from predatory behavior. The under-regulation of the industry enables LFCs to reap excessive profits, especially from high-value, low-risk cases. States should pass comprehensive statutes that cap interest rates based on objective case-risk factors, as well as provide consumers an efficient way to compare LFCs. Part IV proposes specific measures to achieve these ends.

IV. PROPOSED REGULATIONS TO PROTECT AND INFORM CONSUMERS

Rather than under-regulate or over-regulate litigation financing, states should set reasonable interest rate ceilings and provide consumers with the ability to make informed choices when selecting an LFC. Combined with the bedrock protections already introduced by existing laws, graduated rate caps would ensure that LFCs receive profits that are proportional to their assumed risk. Additionally, a centralized LFC resource would empower and inform consumers through direct rate comparisons, LFC ratings and reviews, and other useful tools. This two-pronged regulatory approach would protect consumers from predatory behavior and stimulate

130. *Id.*
131. *Id.*
132. OHIO REV. CODE ANN. § 1349.55 (LexisNexis 2008).
133. NEB. REV. STAT. § 25-3303 to 3304 (2010).
134. Appelbaum, *Lobby Battle*, *supra* note 46.

industry competition.[135]

To determine interest rate ceilings that will bar profiteering but allow LFCs to remain in business, states must first require LFCs to disclose comprehensive business and financial data that reflect LFCs' true costs of doing business.[136] LFCs should be required to divulge information regarding outstanding debt; the number of litigation financing agreements entered into; the total amount of money advanced; the percentage of financed lawsuits that have yielded a profit; the total amount of profits; the amount of money advanced to plaintiffs that was lost; the average time it takes to receive any proceeds; and total business expenses.[137] Disclosures of these numbers would make it possible to assign reasonable rate caps based not only on case value and objective risk factors, but also the profitability, prevalence, and operating costs of litigation financing on a state-by-state basis.[138]

With access to industry data, states could establish fair interest rate caps for individual litigation financing agreements that are proportional to their respective case-risk. Combined with settlement and jury verdict databases, an objective factor analysis would create an approximate tiered system of risk valuation that categorizes cases across claims, fact patterns, types of plaintiffs, and jurisdictions. The graduated interest rate ceilings would correspond with the likelihood of a sufficient recovery for the plaintiff. The case-risk factors for personal injury cases should include, but not be limited to: strict liability; admitted wrongdoing; serious, debilitating, or disfiguring injuries; reckless or willful and wanton conduct; the potential for punitive damages; settlement offers; eyewitnesses; contributory negligence; substantial property damage; significant medical bills; the defendant's available resources; the jurisdiction; the type of claim; and the case's projected time line.[139] For each lawsuit, a complete analysis of these factors

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135. *See* Barksdale, *supra* note 6, at 735–36.

136. *See* McLaughlin, *supra* note 75, at 658. States could collect the data during a licensing process; if the LFC refuses to comply, it would not be permitted to operate.

137. Martin, *Another Subprime Industry*, *supra* note 1, at 103.

138. *See id.*

139. The plaintiff's attorney would be required to attach a brief summary of all the relevant factors on the litigation financing agreement. This would discourage LFCs from manipulating factors in their risk analysis. As later explained, however, a competitive and transparent market would ensure that consumers get the best available rates and only do business with scrupulous LFCs.

would yield an interest rate ceiling that both protects consumers and fairly rewards the LFC.[140]

In conjunction with equitable rate restrictions, states should make LFC-specific information readily available in the form of an online "marketplace."[141] Ideally, this centralized consumer resource would expand access to litigation financing, increase market competition, and enable plaintiffs to efficiently and knowledgeably choose an LFC. To supply consumers with meaningful options in the pursuit of litigation financing, regulators could formulate a standardized LFC application to allow plaintiffs to apply to multiple LFCs through a single form. This tool would not only save significant time and effort, but would efficiently produce a set of competitive rates from a variety of LFCs. Because the consumer would be able to apply to many companies simultaneously, a standardized application would also increase access to litigation financing. For instance, even if most LFCs would reject a particular claim as too high-risk, a centralized marketplace could connect the plaintiff to a company that would be willing to finance the lawsuit.

The marketplace should also allow consumers to quickly compare companies and rates without having to disclose any information to LFCs. Up-to-date LFC profiles would publish the average rates that companies charge across claims and basic fact patterns.[142] Reviews and multi-factor ratings would guide plaintiffs to customer-friendly LFCs that charge reasonable rates. The marketplace would also provide rankings and search features to allow consumers to find the best rates for particular types of claims. Just because an LFC may offer

140. Such an analysis would be technically similar to the review that LFCs already perform. For example, each factor could be assigned a certain value or range of values according to their dollar amount or degree of influence on the outcome of the case. The larger the final sum value, the greater the probability of repayment to the LFC, and the lower the corresponding interest rate ceiling.

141. In addition to requiring LFC websites and advertisements to conspicuously point consumers to the marketplace, LFCs should pay a small tax to fund the creation and maintenance of the website. As for the creation and administration of the marketplace, federal efforts would perhaps be more effective to actually implement and maintain it; states could set statutory interest rate ceilings on their own, while the Consumer Financial Protection Bureau or another federal agency would control the online hub. It would also be possible for a single state or coalition of states to spearhead the project, with further states contributing funds and data at later points.

142. In addition to comprehensive interest rate data, each LFC profile would contain customer ratings; reviews; information regarding the company's size, profitability, and affiliates in the industry; the percentage of applications the LFC accepts; and the total number of accepted applications broken down by claim.

the lowest rates for personal injury lawsuits, for example, does not mean that it would be the optimal choice for worker's compensation claims. Discussion forums would serve as another means of support for consumers, who can direct questions and concerns to other plaintiffs, LFC representatives, or government officials. Finally, the marketplace should provide a calculator that generates estimated interest rate ceilings based on user-inputted facts and numbers for a particular case.

The marketplace would not only level the playing field between plaintiffs and LFCs, but would organically stimulate market competition as well. Because company-specific rates would be available to LFCs and consumers alike, companies would competitively lower rates and additional players would be encouraged to enter the market. In its facilitation of communication between plaintiffs and LFCs, a standardized application would also compel companies to directly compete for a consumer's business. As a result, interest rates would naturally decrease and access to litigation financing might even extend to consumers with higher-risk claims. Ultimately, plaintiffs with extremely low-risk lawsuits would enjoy very low rates, while those who were previously unable to secure litigation financing may be able to finally seek its benefits.

ALFA denies that LFC rates are unnecessarily high and claims that growing numbers of LFCs in the marketplace, in addition to its own self-regulatory presence, are already sufficient for competition to drive down the costs of litigation financing without government intervention.[143] However, the sheer number of LFCs will not effectively drive down rates unless consumers are able to efficiently compare LFCs. Without the capacity to efficiently ascertain their true options for litigation financing, desperate and cash-strapped consumers will probably not select the most cost-effective LFC. More importantly, if consumers cannot even locate the most cost-effective option, competition will not work to drive down interest rates.

CONCLUSION

In order to prevent predatory LFC behavior and still provide access to litigation financing, states must control this

143. *See Frequently Asked Questions*, *supra* note 69.

unique and beneficial practice through a multi-faceted approach. Existing litigation financing laws do not adequately shield consumers from unreasonable interest rates or provide them with clear options. On the other hand, given the associated risks and operating costs that LFCs face, access to litigation financing may become severely limited in states that regulate litigation financing agreements as traditional loans.[144] Rather than forfeit the benefits of litigation financing or give LFCs the power to charge unjustifiable rates, states should directly regulate the industry to protect and empower consumers. Equitable interest rate ceilings based on objective case-risk factors would prohibit LFCs from reaping unreasonable profits from desperate plaintiffs. In conjunction with a centralized LFC marketplace that promotes consumer choice, expands access to litigation financing, and stimulates competition, this legislative action would finally allow consumers to pursue litigation financing at a fair price.

144. *See* Martin, *The Wild West*, *supra* note 8, at 68.