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Litigation Financing: Another Subprime Industry that Has a place in the United States Market

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LITIGATION FINANCING: ANOTHER SUBPRIME INDUSTRY THAT HAS A PLACE IN THE UNITED STATES MARKET

SUSAN LORDE MARTIN*

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I. INTRODUCTION

THE idea that lawsuit plaintiffs could obtain financing that would enable them to pursue their cases, or pursue them more vigorously, began to take hold in the United States more than fifteen years ago.[1] There were several legal impediments to such arrangements, but the ubiquity of the internet made it easy for litigants to find willing lenders and litigation funders to find customers.[2] When the industry of litigation financing

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1. *See, e.g.*, Susan Lorde Martin, *Syndicated Lawsuits: Illegal Champerty or New Business Opportunity?*, 30 AM. BUS. L.J. 485, 498 (1992) (citing Killian v. Millard, 279 Cal. Rptr. 877 (Cal. Ct. App. 1991)) [hereinafter "*Syndicated Lawsuits*"]; Intex Plastic Sales Co. v. Hall, 20 U.S.P.Q.2d (BNA) 1367 (N.D. Cal. 1991)).

2. *See* Susan Lorde Martin, *Financing Litigation On-Line: Usury and Other Obstacles*, 1 DEPAUL BUS. & COM. L.J. 85, 99-100 (2002) (listing on-line litigation financing firms).

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started, the litigation generally involved a business relationship.[3] Today, although there are many situations where businesses large and small will seek partners to undertake some of the expenses involved in pursuing litigation in exchange for some of the proceeds of the lawsuit,[4] the litigation financing industry is most often recognized in the popular, professional and academic presses because of its relationships with poor individual plaintiffs.[5]

The high fees of the funders, when the plaintiffs won their cases, has led commentators and some courts to focus on the ill treatment of the plaintiffs by the funders instead of by the defendants, the cause of the plaintiffs' injuries in the first place. This view is encouraged by large corporations and their insurers as they pursue their general mission of "tort reform."[6] 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?[7]

Now that litigation funding is becoming a better known, mainstream activity, its regulation should be decided by practical realities rather than enforcement of ancient legal doctrines or shock at new financial services. It is merely one of a variety of subprime financial arrangements, such as home mortgages, payday loans, car-title loans and rent-to-own transac-

3. *See, e.g.*, *Killian*, 279 Cal. Rptr. 877; *Intex*, 20 U.S.P.Q. 2d (BNA) 1367.

4. It is difficult to document these arrangements because they are generally private and not disclosed. Nevertheless, it is fairly well known that many large lawsuits, such as the vitamins anti-trust suit, the asbestos cases and the Vioxx cases, have been supported by litigation financing companies which are funded by banks, private equity and hedge funds. *See, e.g.*, Alison Frankel, *Helping Underfunded Plaintiffs Lawyers—at a Price*, AM. LAW., Feb. 13, 2006, *available at* http://www.law.com/jsp/law/LawArticleFriendly.jsp?id=1139565913200.

5. *See, e.g.*, Douglas R. Richmond, *Other People's Money: The Ethics of Litigation Funding*, 56 MERCER L. REV. 649, 649-50 (2005); 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, 758 (2003); Lauren J. Grous, Note, *Causes of Action for Sale: The New Trend of Legal Gambling*, 61 U. MIAMI L. REV. 203, 204 (2006); Mariel Rodak, Comment, *It's about Time: A Systems Thinking Analysis of the Litigation Finance Industry and Its Effect on Settlement*, 155 U. PA. L. REV. 503, 503 (2006); David Dagan, *Lawsuit-Loan Companies Vex Attorneys*, CENT. PENN BUS. J., Jan. 27, 2006, at 3; Diane E. Lewis, *With Interest*, BOSTON GLOBE, Oct. 2, 2003, at C1; 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.

6. *See* Anthony J. Sebok, *Dispatches From The Tort Wars*, 85 TEX. L. REV. 1465, 1498 (2007).

7. Mike France, *The Litigation Machine*, BUS. WK., Jan. 29, 2001, *available at* http://www.businessweek.com/2001/01_05/b3717001.htm?scriptFramed (noting that large corporations like General Motors and DuPont each have more than 100 in-house lawyers, dozens of outside counsel on retainer, giant budgets, high-tech resources and access to firms like Defense Research Institute which has files on 50,000 expert witnesses).

tions, which can empower people without access to more traditional credit sources. For businesses seeking financing to support litigation, practical reality means there should be no legal impediments, beyond those that exist for any business agreement, on any deal they and their funders undertake. For individuals needing financial support to maintain litigation, there are examples in other industries as well as in other countries for regulating litigation funders and determining a reasonable rate of return. Defendants have insurers to finance their litigation expenses; litigation finance firms merely play that same role for plaintiffs, leveling the playing field.

Because this author and others have provided descriptions of the litigation funding industry and its legal background in other articles, this article will start with a very brief introduction to the industry's legal problems.[8] Then there will be a review of the most recent cases involving litigation financing to illustrate how courts address attacks on the industry depending on whether the plaintiff/borrower is a business or an individual.[9] Next, this article will provide a comparison between litigation financing and other subprime financing industries.[10] Section IV discusses the concept of reasonable rate of return and how it applies to litigation financing.[11] Section V discusses the litigation financing industry in Australia and other countries and how it can be instructive for industry behavior and regulation in the United States.[12] Finally, the article concludes that merely because it is possible for litigation financing to be predatory, does not mean it should be eliminated.[13] Litigation financing serves as a counterbalance to a defendant's insurer so that a plaintiff has the wherewithal to remain in the legal battle long enough to have a realistic opportunity to achieve legal success. Litigation financing also serves as an alternative way for businesses to manage risk and cash flow associated with legal proceedings. Regulation of the industry should focus on data collection, transparency and competition.

8. For a discussion of the industry's legal problems, see *infra* notes 14-25 and accompanying text.

9. For a discussion of court approaches, see *infra* notes 26-106 and accompanying text.

10. For a comparison of other subprime lending, see *infra* notes 107-49 and accompanying text.

11. For a discussion of reasonable rates of return, see *infra* notes 150-75 and accompanying text.

12. For a discussion of international litigation funding, see *infra* notes 176-250 and accompanying text.

13. For a discussion of why possible predatory practices should not eliminate the entire industry, see *infra* notes 251-59 and accompanying text.

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II. The Litigation Financing Industry

A. *Background*

"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."[14] These arrangements have been problematic because they violate state prohibitions against champerty, an agreement in which a third party provides support for another's litigation in exchange for part of the proceeds.[15] In addition, although these funding arrangements specifically do not contain an absolute obligation on the part of the borrower to repay the amount of money advanced, a basic element in the definition of usury, some courts have viewed the arrangements as usurious.[16]

The prohibition on champerty has existed since ancient Greek and Roman times.[17] Its purpose was to keep third parties with no relationship to the litigation from encouraging quarrels, frivolous litigation, resistance to settlement, suppression of evidence and increased damages, all for their own personal gain.[18] In the United States today, there is wide variation among states' laws on champerty, but even where it is prohibited there have always been major exceptions, the most notable being contingency legal fees.[19] Moreover, the evils the prohibition was meant to discourage

14. 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).

15. For a discussion of champerty and maintenance, see *Syndicated Lawsuits, supra* note 1, at 485-97; Max Radin, *Maintenance by Champerty*, 24 CAL. L. REV. 48, 51-52 (1935). For a discussion of champerty and maintenance in foreign countries, see *Campbells Cash & Carry Party Ltd. v. Fostif Party Ltd.*, (2006) 80 A.L.J.R. 1441 (Austl.) (describing development of law of maintenance and champerty in UK, Australia and India). In a few states, champerty is not prohibited. *See, e.g.*, Saladini v. Righellis, 687 N.E.2d 1224, 1224 (Mass. 1997); Weller v. Jersey City, Hoboken & Peterson St. Ry. Co., 57 A. 730, 732 (N.J. Ch. 1904), *aff'd*, 68 N.J. Eq. 659 (N.J. 1905). In several others, courts have indicated that the doctrine of champerty should not be rigidly enforced. *See, e.g.*, Kraft v. Mason, 668 So. 2d 679, 682-83 (Fla. Dist. Ct. App. 1996) (discussing decreased need for strict prohibitions on champerty); Osprey, Inc. v. Cabana Ltd. P'ship, 532 S.E.2d 269, 279 (S.C. 2000) (abolishing champerty as defense and expressing confidence that other more well-developed principles of law can accomplish same goals).

16. *See, e.g.*, Rancman v. Interim Settlement Funding Corp., No. 20523, 2001 WL 1339487, at *1 (Ohio Ct. App. Oct. 31, 2001), *aff'd*, Rancman v. Interim Settlement Funding Corp., 789 N.E.2d 217, 218 (Ohio 2003); *see also* Lawsuit Financial, LLC v. Curry, 683 N.W.2d 233, 240 (Mich. Ct. App. 2004); Echeverria v. Estate of Lindner, 2005 WL 1083704, at *1 (N.Y. Sup. Ct. Mar. 2, 2005) (unpublished disposition) (noting, in dicta, that litigation funding rate was "obviously usurious"). For a description of usury in the context of litigation financing agreements, see Martin, *supra* note 2, at 89-92.

17. For a discussion of the history of champerty, see Radin, *supra* note 15 at 51-52 and accompanying text.

18. *See* A.L.G., Note, *The Effect of Champerty on Contractual Liability*, 79 L.Q. REV. 493, 494 (1963).

19. For a discussion of the various state laws addressing champerty, see *Syndicated Lawsuits, supra* note 1, at 488-97.

are counteracted by lenders' desire to support only those lawsuits that are likely to succeed and courts' abilities to sanction lawyers and parties who bring frivolous suits.

The prohibition on usury also has an ancient history.[20] Usury is generally defined as intentionally taking greater compensation than the law allows for lending money to a borrower who has an absolute obligation to repay with repayment not contingent on any other event.[21] In the United States, states' laws on usury are quite varied, but most states have statutes setting interest rate limits and prohibiting usury.

In spite of potential champerty and usury pitfalls, there are more litigation financing firms than ever before,[22] new firms are offering financing to lawyers to pursue lawsuits,[23] and even hedge funds have started investing in lawsuits.[24] Nevertheless, at the same time the industry is becoming larger and more mainstream, there are still lawsuits attempting to get courts to invalidate litigation financing agreements.

B. *Recent Legal Attacks on Litigation Financing Agreements*

These cases generally arise when a plaintiff, usually an individual with a personal injury claim who does not have enough money for living expenses during the time between the injury and the disposition of the case, accepts funds from a litigation funding firm. The agreement details the amount advanced, the fact that the plaintiff/borrower will not have to repay the funds unless the claim succeeds, and if the claim succeeds, the amount the plaintiff/borrower will have to pay, usually an amount that increases as the time between the advance of funds and resolution of the case increases.[25] When the underlying case is resolved, the plaintiff/borrower refuses to pay the funding firm the agreed upon amount and either

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20. *See* Jeremy Bentham, *Letter II.*, *in* DEFENCE OF USURY; SHOWING THE IMPOLICY OF THE PRESENT LEGAL RESTRAINTS ON THE TERMS OF PECUNIARY BARGAINS 9 (1787); Paul G. Hayeck, *An Economic Analysis of the Justification for Usury Laws*, 15 ANN. REV. BANKING L. 253, 253 (1996); Wayne A.M. Visser & Alastair McIntosh, *A Short Review of the Historical Critique of Usury*, *in* ACCOUNTING, BUSINESS AND FINANCIAL HISTORY 175 (vol. 8) (1998).

21. For a discussion of usury, see Martin, *supra* note 2, at 89-91.

22. Entering "litigation financing" on Google will provide more than fifty different funding firms. Search Results for "litigation financing," http://www.google.com/search?hl=en&q=litigation+inancing&btnG=Google+Search (last visited Sept. 18, 2007). For a discussion of litigation funding firms and a list of some of them, see Martin, *supra* note 2, at 99-100, nn.106-18.

23. *See, e.g.*, Legal Asset Funding v. Veneski, No. 3:04-CV-01156, 2006 WL 2623884 (M.D. Pa. Sep. 12, 2006); Counsel Financial Services, http://www.counselfin.com (last visited Apr. 10, 2007); Attorney Funding Group, LLC, http://www.attorneyfundinggroup.com (last visited Oct. 29, 2007).

24. Mary Jacoby, *U.K. Auditions Litigation*, WALL ST. J., Jan. 16, 2007, at A12 (noting that hedge funds, insurers and private investors are providing support for lawsuits in exchange for share of any award).

25. *See, e.g.*, CapTran, http://www.captran.com/aboutfees.asp (last visited Oct. 16, 2007).

sues for a rescission of the agreement claiming champerty or usury, or is sued for breach of contract.

The most notorious of the cases was *Rancman v. Interim Settlement Funding Corp.*,[26] because the Ohio Supreme Court resurrected the prohibition against champerty to invalidate the funding agreements although the plaintiff/borrower never raised champerty as an issue, and the financing firm was not given the opportunity to speak to the issue.[27] Furthermore, the case was interesting because the intermediate appellate court in Ohio invalidated the agreements on the grounds of usury, holding that the plaintiff's underlying case was a sure winner; and, therefore, the funding firm made a loan, not a contingent cash advance.[28] The Ohio Supreme Court obviously wanted to affirm the lower court and void the agreement, but did not want to determine "the threshold level of risk necessary for a contingent advance to be treated as an investment rather than a loan,"[29] instead drawing on the champerty doctrine that, it admitted, had "lain dormant in Ohio courts."[30]

Rancman is probably an example of bad facts making bad law. The plaintiff was a passenger injured in a car accident.[31] The circumstances of the injury led the court to believe that there was no real probability the plaintiff would not be paid for her injury.[32] Nevertheless, her litigation financing firm charged her over 280% in fees for money it advanced.[33] Although the plaintiff had advice of her counsel regarding the agreement, which she chose to reject, and there was no evidence about the firm's profit margin, the court was not going to uphold an agreement with that percentage number.

Poor individuals are not the only recipients of funds from litigation funding firms.[34] These arrangements are becoming increasingly common in business situations, where they began, and it is more likely that courts will uphold agreements between a funding firm and a business than between a funding firm and an individual. In one of the most recent reported cases, the Texas Court of Appeals upheld a litigation funding agreement against Anglo-Dutch Petroleum International, Inc.[35] The case

26. 789 N.E.2d 217 (Ohio 2003).

27. *See id.* at 219-20.

28. *See* Rancman v. Interim Settlement Funding Corp., No. 20523, 2001 WL 1339487, at *2 (Ohio Ct. App. Oct. 31, 2001).

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

30. *See id.* at 220. For detailed descriptions of these Ohio cases, see *Syndicated Lawsuits*, *supra* note 1, at 59-62; Martin, *supra* note 2, at 92-94.

31. *Rancman*, 789 N.E.2d at 219-20.

32. *See Rancman*, 2001 WL 1339487, at *2.

33. *See id.* at *1.

34. *See, e.g.*, CapTran, http://www.captran.com/aboutfees.asp (last visited Oct. 16, 2007) (giving litigation funding to poor individuals and attorneys); *see also* Anglo-Dutch Petroleum Int'l, Inc. v. Haskell, 193 S.W.3d 87 (Tex. App. 2006) (litigation funding to business for trade secret appropriation case).

35. *See Haskell*, 193 S.W.3d 87.

is a good example of the kind of circumstances in which a business plaintiff might want to secure financial support for its litigation from someone else, the potential pitfalls for litigation financing firms, and the reaction of courts to these kinds of facts.

Anglo-Dutch had a pending $650 million lawsuit against Halliburton and Ramco for misappropriating trade secrets and breaching confidentiality agreements.[36] Because Anglo-Dutch did not have the resources to run its business and prosecute this very expensive case, it sought, unsuccessfully, to borrow money from commercial banks using the lawsuit as collateral.[37] Then it solicited other investors and received $560,000 in exchange for shares of the proceeds of the Halliburton lawsuit if there were any.[38]

The agreements between Anglo-Dutch and its investors provided that Anglo-Dutch was selling interests in any cash recovery it would receive from the Halliburton lawsuit, and that if there were no cash recovery, Anglo-Dutch would not have to return their money or pay anything to the investors.[39] If there were a cash recovery, then Anglo-Dutch would pay each investor "the sum total of: (a) its Investment, plus, (b) an amount equal to its Investment, plus (c) a return on its Investment . . . ."[40] The formula used to calculate the return on investment (part c) generally provided for an amount equal to the amount of the loan multiplied by the number of days between the making of the loan and the disposition of the Halliburton case divided by 365.[41] In other words, after a year the return to investors on the money they advanced would be 200%.

Anglo-Dutch received an $81 million judgment in the Halliburton case and entered into a settlement agreement with Halliburton without disclosing the terms.[42] Anglo-Dutch then requested its investors to accept less than the agreed upon amount asserting that their agreements were "contrary to Texas public policy and unenforceable under Texas law."[43] The investors refused and sued Anglo-Dutch claiming breach of contract and other wrongs.[44] In its defense, Anglo-Dutch asserted that the litigation funding agreements were usurious loans, or they were illegal unregistered securities, both of which violate Texas public policy.[45]

To support its usurious loan claim, Anglo-Dutch used the *Rancman* argument, that is, its case was a sure thing, and in reality, there was no

36. *See id.* at 90.
37. *See id.*
38. *See id.* at 91.
39. *See id.* at 92.
40. *Id.*
41. *See id.* n.5.
42. *See id.* at 91.
43. *Id.* (quotations omitted).
44. *See id.*
45. *See id.* at 93.

contingency.[46] The Texas Court of Appeals responded in a much more sophisticated way than the Ohio Court of Appeals. The Texas court distinguished between "contingency" and "risk."[47] By the unambiguous terms of their agreement, Anglo-Dutch did not have an absolute obligation to repay its investors; its obligation was contingent upon its cash recovery in the Halliburton suit.[48] Therefore, the agreements cannot be usurious.[49] Usury depends on a contingency, not on the amount of risk.[50] It does not matter, according to the Texas court, whether or not the investors were exposed to little or no risk.[51] The reality of the contingency, according to the court, was illustrated by the fact that the $81 million judgment Anglo-Dutch received was far less than its anticipated damages of $650 million.[52] Furthermore, to ignore the unambiguous contingency in the agreement would render every successful business venture subject to a usury claim.[53] Once a business venture was successful, a borrower could claim that the investment agreement was really a loan, and therefore, should be voided because it was usurious.[54] Investors, who undertook a financial risk, advancing funds because of promised returns, would be denied the benefit of their bargain.[55]

The Texas court also addressed the Anglo-Dutch claim that because its agreements with investors were champertous, they were ipso facto void as against public policy.[56] The court averred that the agreements did not "prey on financially desperate plaintiffs."[57] To the contrary, it was Anglo-Dutch who solicited investors when it could not obtain a loan from a commercial bank, and the investment returns were bargained for by the parties.[58] The investors did not exert any control over the lawsuit against Halliburton, and it is more likely that the agreements would encourage settlement rather than prolong litigation.[59] Investors would not fund a frivolous lawsuit when the only way they can recover their investment is if the lawsuit is successful, and they would not prolong litigation when their agreements were structured in such a way that a quicker settlement was in their interest.[60] Accordingly, the Texas court concluded that the litigation financing agreements did not violate Texas public policy and affirmed the

46. *See id.* at 94.
47. *See id.* at 96.
48. *See id.*
49. *Id.* at 97.
50. *Id.*
51. *See id.* at 96-98.
52. *See id.* at 98.
53. *See id.* at 99 n.8.
54. *See id.*
55. *See id.*
56. *See id.* at 104.
57. *Id.*
58. *See id.*
59. *See id.* at 104-05.
60. *See id.* at 105.

lower court's decision awarding the investors $2,556,105.51 in actual damages and $52,001.80 in attorney fees.[61]

The Texas appellate court in *Anglo-Dutch,* while deciding this case of first impression in Texas, was clearly comfortable enforcing the litigation financing agreement, viewing it as an investment arrangement.[62] The contrast with the opinion of the District Court of Appeal of Florida six months earlier in *Fausone v. U.S. Claims, Inc.*[63] is striking, but predictable given the facts of the case. A dump truck struck Victoria Fausone while she was riding her bicycle.[64] Five months after the accident she entered into an agreement with Advance Legal Funding, LLC ("ALF").[65] By the terms of the agreement, she received $3000 in October 2000 and agreed to pay ALF $6000 if she settled her claim before May 1, 2001, or $9000 plus 18% interest if a settlement occurred after that date.[66] She would pay nothing if she lost her lawsuit.[67] The court noted that the interest rate in the agreement was never less than 200%.[68]

Fausone then entered into an agreement with Advance Settlement Funding, Inc. ("ASF"), and by its terms she received $2000 for which she would repay no more than $4250 depending on when she received the proceeds from the lawsuit.[69] The court noted that the interest rate was approximately 90%.[70] Fausone entered into two more agreements with ASF agreeing to pay a total of $8075 from the proceeds of her lawsuit.[71] She then contacted U.S. Claims ("USC") seeking more money.[72] Fausone's attorneys reviewed the agreement with USC, sent it to USC and provided USC with information about her case so USC could decide whether to advance funds to her.[73] USC helped her consolidate her loans and pay off the earlier ones at a discount.[74] The agreement provided that Fausone would not have to pay anything to USC if she failed to recover any money from her lawsuit, and that if the proceeds of the lawsuit were less than the amount that she owed USC, USC would be entitled to 100% of the proceeds from the lawsuit.[75] USC advanced a total of $30,000 to Fausone, and their agreement contained a repayment schedule that required her to repay $42,890 by a certain date, along with increasing

61. *See id.* at 94, 105.
62. *See id.* at 100.
63. 915 So. 2d 626 (Fla. Dist. Ct. App. 2005).
64. *See id.* at 627.
65. *See id.*
66. *See id.*
67. *Id.*
68. *See id.*
69. *See id.*
70. *See id.*
71. *See id.*
72. *See id.*
73. *See id.*
74. *See id.* at 628.
75. *See id.*

amounts if her case took longer to resolve.[76] The court noted that although these terms were better than those in the agreements with ALF and ASF, "the interest rate for these loans was still well above the rates normally allowed for consumer transactions."[77] The court did not discuss whether Fausone was able to get loans from commercial banks or other traditional sources. Presumably, she could not do so, or certainly her attorneys would have suggested that course. The agreement also provided that any disputes would be settled by arbitration in either Pennsylvania or Delaware.[78]

About a year and a half after Fausone and USC signed the agreement, Fausone's attorney notified USC that Fausone's claim had been settled for more than $200,000 but that Fausone had instructed him not to pay USC.[79] USC proceeded with an arbitration in Philadelphia.[80] The arbitrator offered Fausone the opportunity to appear by telephone, but she did not, and USC was awarded $72,117 with a provision that the amount would continue to increase in accordance with the schedule in the agreement if Fausone failed to pay.[81] Because Fausone made but then withdrew a motion to vacate the arbitration award, the appellate court had no choice but to affirm the lower court's confirmation of the arbitration award after USC had filed a motion urging that action.[82]

Unlike the Texas court in *Anglo-Dutch*, the Florida court was dissatisfied with the outcome of this case and could not resist providing a section in its opinion called "A Possible Need for Regulation."[83] The court opined that:

> 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 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 a nonrecourse loan . . . . The purchase agreement in this case is one-sided and designed to prevent a Florida citizen from having access to a local court or another local dispute resolution forum. Such agreements create

76. *See id.*

77. *Id.*

78. *See id.*

79. *See id.* at 628-29.

80. *See id.* at 629 (noting that case went to American Arbitration Association in Philadelphia).

81. *See id.* at 629 n.5 (summarizing the repayment schedule contained in initial and amended agreements). The court also noted that it was unclear as to whether the amount owed had continued to increase during the litigation and arbitration proceedings. *See id.*

82. *See id.* at 629.

83. *See id.* at 629-30.

> confusion concerning the party who actually owns and controls the lawsuit, and creates risks that the attorney-client privilege will be waived unintentionally.[84]

The court then suggested that the Florida legislature examine the litigation financing industry and, perhaps, provide statutory protection from it for Florida's citizens.[85]

The court's conclusion in dicta is not necessarily a poor one, but its reasoning is poor. It would seem that when the court saw a 200% interest rate, the court concluded that the plaintiff/borrower was being "victimized," although (1) Fausone had aid of counsel in pursuing the financing arrangements; (2) Fausone probably needed the money and could not get it from traditional lenders or elsewhere; (3) there are many litigation financing firms, so there is probably some competition in setting fees; and (4) the court did not indicate it had any information about the cost of money to the litigation financing firm, its overall success rate in collecting fees, its overall rate of return, or anything else about its business. Thus, it is a good idea for legislatures to examine the litigation financing industry, but it is conclusory for the Florida court to assume the victimization of this plaintiff/borrower.

Several months before *Fausone*, a case was heard in a New York trial court that had an outcome different from either *Fausone* or *Rancman* but, like both those cases, is an excellent example of judicial antipathy to litigation financing arrangements for individual plaintiff/borrowers.[86] The case was an inquest in which the court had to determine only the issue of damages suffered by Juan Echeverria, an undocumented laborer, when he fell from an elevated platform on his job site and sustained significant head and back injuries.[87] Among the damages claimed was money owed to LawCash, a litigation funding firm that had advanced $25,000 to Echeverria at what the court called "an obviously usurious rate of interest of 3.85% per month compounded monthly."[88] The funds were used to pay for surgery and expenses associated with it.[89] The court referred to *Rancman*, noting that "the Ohio Supreme Court is the highest court of that state and should be shown proper deference."[90] With obvious dismay, the New York court opined that it could not find Echeverria's agreement void on the grounds of champerty because New York law prohibits such a finding under the circumstances.[91]

84. *Id.* at 630.

85. *See id.*

86. *See* Echeverria v. Estate of Lindner, No. 018666/2002, 2005 WL 1083704, at *1 (N.Y. Sup. Ct. Mar. 2, 2005) (unpublished table decision).

87. *See id.*

88. *Id.*

89. *See id.* at *2.

90. *Id.* at *6-7 (referencing *Rancman v. Interim Settlement Funding Corp.*,789 N.E.2d 217, 220-21 (Ohio 2003).

91. *See id.* at *6.

First, under New York law, an investment in a lawsuit can be champertous only if the investment is made "'with the intent and for the purpose of bringing an action or proceeding thereon.'"[92] In this case, Echeverria had already started legal proceedings before entering his agreement with LawCash and, according to the agreement, he remained in control of the lawsuit.[93] Furthermore, the New York Attorney General had recently entered into an agreement with a major litigation financing firm in the state, requiring the firm to make full disclosure of the total amount and the interest rate the plaintiff/borrower would owe, to provide a five day right-to-cancel period, and to obtain from the plaintiff's attorney a statement that the agreement was reviewed with and explained to the plaintiff.[94] Thus, the court reluctantly concluded that "the Attorney General seems to have given these types of funding institutions his blessing."[95]

The court then proceeded to follow the path of the intermediate appellate court in *Rancman*, the path rejected by the Ohio Supreme Court because it did not want to decide when a business risk was too low to qualify as a contingency.[96] The New York court declared that Echeverria's case was "'a sure thing' [and], therefore, it is a loan, not an investment with great risk. If it is a loan, then the interest rate charged is usurious . . . ."[97] The court set aside the agreement and awarded the principal of $25,000 and interest of 16% per annum, the maximum rate allowable for a loan under New York law.[98] The court called on the New York legislature to examine litigation funding firms to decide if they are engaging in champerty,[99] and it called on the Attorney General to issue an opinion letter with rules for litigation funders to protect consumers.[100]

Once again, a court just did not like the idea of a business charging a high interest rate to an individual who was pursuing a lawsuit. The court acknowledged it had "pontificated"[101] in its opinion but nevertheless could not refrain from predicting that litigation funding agreements could lead to premature settlements or no settlements at all, while at the same time worrying that people would bring lawsuits with a low likelihood of success.[102] The court did recognize that litigation financing arrange-

92. *Id.* at *4 (citing N.Y. JUD. LAW §§ 488, 489).

93. *See id.* at *5.

94. *See id.* at *3.

95. *Id.* at *8.

96. *See* Rancman v. Interim Settlement Funding Corp., No. 20523, 2001 WL 1339487, at *2 (Ohio Ct. App. Oct. 30, 2001) (explaining factors used by litigation firms to determine amount of risk involved in individual personal injury case), *aff'd*, 789 N.E.2d 217 (Ohio 2003).

97. Echeverria v. Estate of Lindner, No. 018666/2002, 2005 WL 1083704, at *8 (N.Y. Sup. Ct. Mar. 2, 2005) (unpublished table decision).

98. *See id.*

99. *See id.* at *7.

100. *See id.* at *8.

101. *Id.* at *12.

102. *See id.* at *7-8.

ments would allow low income plaintiffs to bring lawsuits they would otherwise not have the resources to pursue;[103] however, it did not mention that it was unlikely that a funder would finance a frivolous suit. Most importantly, it incorrectly assumed that an investment creates a "great risk" for the investor; and absent this great risk, the purported investor is merely a lender making a loan and is bound by usury laws.[104] The Texas court in *Anglo-Dutch* got it right when it recognized that an investment does not become a loan merely because the level of risk is low.[105] The New York court in this case reflected a general dislike of subprime arrangements.

III. SUBPRIME LENDING

Litigation financing is not a unique industry. It is related to a widespread subprime lending industry that includes loans for home mortgages, payday loans, car-title loans and rent-to-own stores. A similarity among these examples is that they all involve a rate of return that is higher than that of traditional commercial lenders because the recipients are individuals who do not qualify for prime loans.[106] Funding recipients in the case of litigation financing may differ from borrowers in the other situations because they are not always poor individuals; sometimes they are businesspeople making business decisions to share the costs, risks and potential rewards of their litigation. It is the situation of the poor individual borrower, however, that creates antipathy toward the entire subprime industry. Failure of subprime home mortgage lenders is the most recent example of general political hysteria about the idea of subprime lending.[107] Amid the decrial of these arrangements, there should also be consideration of the important services they provide and how to maximize their positive aspects while minimizing their potential abuses. A brief look at various subprime lending situations provides insight into litigation financing agreements.

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103. *See id.* at *7.

104. *See id.* at *8.

105. *See generally* Anglo-Dutch Petroleum Int'l v. Haskell, 193 S.W.3d 87, 96-99 (Tex. App. 2006) (discussing impact low level of risk has on investment), *reh'g denied*, Dec. 15, 2006. For further discussion of the court's holding in *Anglo-Dutch*, see *supra* notes 35-62 and accompanying text.

106. For a brief discussion of subprime and predatory lending, see Martin, *supra* note 14, at 63-67.

107. *See, e.g.*, *Mortgage Market Turmoil: Causes and Consequences: Hearings Before the S. Comm. on Banking, Housing and Urban Affairs*, 110th Cong. (2007) (statement of Sen. Christopher J. Dodd, Chairman, Comm. on S. Banking, Housing, and Urban Affairs) (recognizing present-day implosion of the mortgage market); *see also* Greg Ip and Damian Paletta, *Lending Oversight: Regulators Scrutinized in Mortgage Meltdown*, WALL ST. J., Mar. 22, 2007, at A1.

A. *Home Mortgages*

In March of 2007, Senator Robert Menendez of New Jersey denounced "the consumer exploitation occurring in subprime lending . . . [by] [u]nscrupulous predatory lenders [who] prey upon the innocent and unsuspecting."[108] There is no widely accepted legal definition of predatory lending, but it usually refers to transactions in which lenders try to fool or intimidate consumers into signing loan agreements that the borrowers cannot afford and that do not meet industry standards.[109] The U.S. Department of Housing and Urban Development and the U.S. Treasury Department issued a report in 2000 that described four different predatory practices in home mortgage lending: (1) loan flipping, that is, repeatedly refinancing loans in a short period of time and including high fees in each new loan, reducing the equity in the home; (2) excessive fee packing, that is, adding very high fees to the loan amount instead of having fees paid up front, so that consumers are often unaware of the fees; (3) lending without regard for the ability to repay; and (4) fraud, that is, appraisers and brokers conspiring to inflate property values.[110] Senator Christopher Dodd of Connecticut reported that:

> a sort of frenzy gripped the market over the past several years as many brokers and lenders started selling these complicated mortgages to lower-income borrowers, many with less than perfect credit, who they knew, or should have known, would not be able to afford to repay these loans when the higher payments kicked in.[111]

Senator Dodd then described a widow with children and an elderly retired woman, "the human tragedies," who were going to lose their homes because of predatory lending.[112]

Subprime lending, on the other hand, does not involve deceit, but is offered to people who have a history of credit problems at an interest rate that is higher than the rate available to those with good credit.[113] The higher rate accommodates the additional risks involved in lending to peo-

108. 153 CONG. REC. S3077, 3114 (daily ed. Mar. 14, 2007) (statement of Sen. Menendez).

109. *See* Freddie Mac, *Combating Predatory Lending*, http://www.freddiemac.com/corporate/about/how_we_help/predlend.html (last visited Oct. 8, 2007) (defining term "predatory lending"); *see also* U.S. GEN. ACCOUNTING OFFICE, CONSUMER PROTECTION: FEDERAL AND STATE AGENCIES FACE CHALLENGES IN COMBATING PREDATORY LENDING 1 (2004).

110. *See* Giang Ho & Anthony Pennington-Cross, *The Varying Effects of Predatory Lending Laws on High-Cost Mortgage Applications*, 89 FED. RES. BANK OF ST. LOUIS REV. 39, 39-40 (2007) (citing U.S. DEP'T OF HOUSING AND URBAN DEV. & U.S. DEP'T OF THE TREASURY, CURBING PREDATORY HOME MORTGAGE LENDING 2 (2000)).

111. Statement of Sen. Dodd, *supra* note 107.

112. *Id.*

113. *See* Freddie Mac, *Subprime Lending*, http://www.freddiemac.com/corporate/about/how_we_help/subprime.html (last visited Oct. 8, 2007).

ple with poor credit histories or no credit history at all.[114] There is very little subprime lending by national banks. Most subprime mortgage lending is done by non-bank lenders and brokers fueled by the purchase of these loans in the secondary market by hedge funds and private equity investors.[115] In 2005 and 2006, about 20% of all mortgage originations were subprime.[116]

At the end of 2006 the Office of the Comptroller of the Currency, the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision and the National Credit Union Administration issued guidelines for nontraditional mortgages.[117] In fact, the guidelines apply only to national banks that are not making most of the subprime loans; nevertheless, the guidelines are instructive for seeing what these federal agencies view as appropriate for maintaining financial opportunities for poorer consumers while protecting them from abuses.[118] The guidelines have two main thrusts. First, they require an analysis of a borrower's repayment capacity based on verified data rather than on credit scores and other assumptions.[119] Second, they require providing clear and balanced information so that borrowers are aware of the risks of the loans.[120]

Because most subprime lenders are regulated by the states, not by federal agencies, states have also been active in attempting to limit abusive lending practices. At least thirty-six states and the District of Columbia have enacted anti-predatory lending laws.[121] In 2006, the Conference of State Bank Supervisors (CSBS) contracted with the National Association of Securities Dealers, Inc. (NASD) to develop a national licensing system that contains data about every company and mortgage professional and is now available to consumers.[122]

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114. *See id.*

115. *See Mortgage Market Turmoil: Causes and Consequences: Hearing Before the S. Comm. on Banking, Housing and Urban Affairs*, 110th Cong. 2-3 (2007) (Statement of Emory W. Rushton, Senior Deputy Comptroller, Chief National Bank Examiner, Office of the Comptroller of the Currency).

116. *See id.* at 4 (noting percentages of subprime mortgage originations).

117. *See* OFFICE OF THE COMPTROLLER OF THE CURRENCY, ET AL., INTERAGENCY GUIDANCE ON NONTRADITIONAL MORTGAGE PRODUCT RISKS 1 (2006), *available at* http://www.ots.treas.gov/docs/2/25244.pdf.

118. *See id.*

119. *See id.* at 5 (explaining combination of factors other than credit scores and assumptions that should help determine borrower's repayment capacity).

120. *See id.* at 18, 20.

121. *See Mortgage Market Turmoil: Causes and Consequences: Hearing Before the S. Comm. on Banking, Housing and Urban Affairs*, 110th Cong., 2007 WL 867455 (F.D.C.H.) (testimony of Joseph A. Smith, Jr., North Carolina Commissioner of Banks). The first anti-predatory lending law was enacted in North Carolina in 1999. *See id.* (referencing N.C. GEN. STAT. § 24-1.1E (1999)).

122. For a discussion of the actions of CSBS and NASD, see Testimony of Joseph A. Smith, *supra* note 121.

If the federal guidelines or state lending laws are hypothetically applied in the litigation financing situation, there seems to be considerably less potential for harm than in the subprime mortgage arena. If the plaintiffs/borrowers do not recover in their lawsuits, they do not have to repay the money advanced. There is no harm that approaches losing one's home. Furthermore, the plaintiffs/borrowers have lawyers who are additional sources of information about the agreements they are undertaking. The political outrage in the subprime mortgage situation is fueled by consumers losing their homes. In the litigation financing situation, outrage is caused merely by the amount of the interest rate, despite the fact that these borrowers cannot get the money elsewhere at a lower rate, and the fact that they have expert advisors.

Sandra Braunstein, the Federal Reserve Board's Director of Consumer Affairs, told a U.S. House Oversight and Government Reform subcommittee that bank regulators must keep incentives for subprime lenders so people with poor credit histories will continue to be able to obtain mortgages.[123] She described the goal as eliminating unfair and abusive practices while preserving incentives.[124] The same could be said for litigation financing and, therefore, the licensing system proposed for mortgage professionals should be similarly efficacious for litigation funders.

B. *Payday and Car-Title Loans*

Payday and car-title loans are other examples of subprime lending that consumer groups, academics and the popular media have been vigorously attacking as predatory for at least the last decade.[125] In a typical payday loan arrangement, the borrower gives the lender a post-dated

123. *See Business Briefs: Preserving Incentives for Subprime Lenders*, NEWSDAY, May 22, 2007, at A52.

124. *See id.*; *see also* Austan Goolsbee, *'Irresponsible' Mortgages Have Opened Doors to Many of the Excluded*, N.Y. TIMES, Mar. 29, 2007, at 2 (warning against tightening regulations on subprime lending too much); *Readjusting Mortgages—Subprime Loans Open Door to Home Ownership, but Must Be Regulated*, NEWSDAY, Apr. 9, 2007, at A40 (editorializing that subprime lending should be regulated, not banned).

125. *See, e.g.*, Creola Johnson, *Payday Loans: Shrewd Business or Predatory Lending?*, 87 MINN. L. REV. 1, 25-97 (2002); Pearl Chin, Note, *Payday Loans: The Case for Federal Legislation*, 2004 U. ILL. L. REV. 723, 753 (2004) (denouncing payday loans as unconscionable and arguing for increased regulation by Congress of payday loan industry); JEAN ANN FOX, CONSUMER FEDERATION OF AMERICA, THE GROWTH OF LEGAL LOAN SHARKING: A REPORT ON THE PAYDAY LOAN INDUSTRY 1 (1998), http://www.consumerfed.org/pdfs/The_Growth_of_Legal_Loan_Sharking_1998.pdf; Adam Geller, *Payday May Day: Short-Term Lenders under Fire—Critics Say They Use Loophole in Law to Charge Usurious Rates*, HOUSTON CHRON., Jan. 26, 2001, at 1C; Joe Harwood, *Fast Loans Cost Oregon Consumers a Bundle*, EUGENE REG.-GUARD, Nov. 10, 1997; David Ivanovich, *Check Cashers or Loan Sharks? Consumer Group Blasts Pricey Industry, Practice of "Payday Loans,"* HOUSTON CHRON., Aug. 22, 1997, at 2C; Jane Bryant Quinn, *Dragged Down by Debt: People with Shaky Credit Are Getting Suckered by Risky Loans Against Their Paychecks, Homes—and Even Cars*, NEWSWEEK, May 7, 2007, at 49; Sherri Williams, *Group Seeks Limits on Payday Lending*, COLUMBUS DISPATCH, May 8, 2007, at 1B.

check for the amount of the loan principal plus the finance charge, and the lender gives the borrower a loan in cash with repayment due in a short time, usually two weeks (the borrower's next payday).[126] At the end of the loan period, either the borrower pays the principal and the finance charge or the lender cashes the check.[127] Examples of such arrangements that have been cited in litigation include a $200 loan for a two-week period with a $25 dollar finance charge for an annual percentage rate of 268.38%[128] and a $400 loan for a two-week period with a $50 finance charge for an annual percentage rate of 325.89%.[129] Even more burdensome than these initial agreements are the rollovers borrowers often undertake because they cannot pay off their loans and fees when they come due. One lawsuit described a borrower who rolled over loans twenty-four times in fifteen months, borrowing $400, paying $1,364 and still owing $248.[130]

Borrowers getting car-title loans will usually borrow between $250 and $2,500 for thirty days, giving the lenders their titles and a set of duplicate car keys as security.[131] Borrowers pay a fee up front which creates an interest rate above 100%, and if they cannot pay when the loan comes due, they are charged another fee plus interest.[132] If they cannot pay the fee and interest, they lose their cars.[133] In one case the borrower took a $1,000 loan and used her 1997 Saturn as collateral.[134] Over the next eighteen months, she paid the lender $4,000, more than she had paid for her car when she bought it, but the principal never decreased, and she still owed $1,200 despite paying $220 each month plus several late fees and other penalties.[135]

Most states now regulate payday and car-title loans by either prohibiting them or putting caps on their interest rates; nevertheless, online lenders get around the rules by locating in states or international sites with weak regulations.[136] On a federal level, Congress included in the National Defense Authorization Act for Fiscal 2007 a limit of 36% as the annual

126. *See, e.g.*, Cash in a Flash v. McCullough, 853 N.E.2d 533, 535-36 (Ind. Ct. App. 2006).

127. *See id.* at 536.

128. *See id.* at 535.

129. *See* Midwest Check Cashing, Inc. v. Richey, 728 N.W.2d 396, 397 (Iowa 2007).

130. *See* Fox, *supra* note 125, at 6.

131. *See* Quinn, *supra* note 125.

132. *See id.*

133. *See id.*

134. *See* Marc Perrusquia, *Suit, Bill Go after "Gouge": In 18 Months, $4,000 Paid on $1,000 Loan*, MEMPHIS COM. APPEAL, Feb. 8, 2007, at A1.

135. *See id.*

136. *See* Eileen Ambrose, *High-Cost Borrowing—Internet Payday Loans: Easy Cash or Shark Attack?*, NEWSDAY, Dec. 24, 2004, at E2.

percentage rate payday lenders may charge soldiers and their spouses.[137] Senator Talent noted that military families pay about $80 million in payday loan fees each year with average annual percentage rates between 400% and 800%.[138] He cited the case of one naval petty officer who took a $300 payday loan in 2003, borrowed to service the fee, and by the beginning of 2004 had paid about $5,000 in interest on $1,800 in payday loans from four different lenders.[139] Consumer advocates have praised the federal legislation, but have asked why its protection does not cover everyone instead of just military families.[140]

The high interest rate is a similarity between these kinds of loans and litigation financing but, once again, the differences are striking. Senator Talent described the young men and women serving in the military and how they are affected by payday loans: they are just out of high school; they are not financially sophisticated; when they cannot pay back the loans and interest, they go into bankruptcy; then they cannot get security clearance, and they cannot do their jobs.[141] Recipients of litigation financing are in much different situations. First, they have lawyers representing them who know and understand the terms of the financing agreements. They are receiving professional advice that they may or may not decide to follow. The agreement is not going to cause them to lose their homes, their cars, their pay or their jobs. The agreement is going to enable them to maintain a lawsuit through which they may collect a substantial amount of money. If, in fact, they lose their lawsuits, they keep the funds advanced to them and do not have to pay anything at all.

C. *Rent-to-Own*

Finally, predatory lending discussions often include information on rent-to-own transactions.[142] In the typical rent-to-own transaction, a consumer acquires household goods by making weekly or monthly payments.[143] Then, at the end of each week or month, the consumer decides whether to return the goods with no further obligation or to keep the goods and to continue making weekly or monthly payments.[144] The consumer can purchase the goods by renting them for an agreed-upon num-

137. *See* 152 CONG. REC. S6323, 6406 (daily ed. June 22, 2006) (statement of Sen. Talent).

138. *See id.*

139. *See id.*

140. *See, e.g.*, Quinn, *supra* note 125; Williams, *supra* note 125.

141. *See* 152 CONG. REC. S6405-1 (daily ed. June 22, 2006) (statement of Sen. Talent).

142. *See, e.g.*, Press Release, Defense Dep't Documents: U.S. Navy Releases, Service Members Find Out about Predatory Lending (Feb. 17, 2007).

143. *See* Susan Lorde Martin & Nancy White Huckins, *Consumer Advocates Vs. The Rent-to-Own Industry: Reaching a Reasonable Accommodation*, 34 AM. BUS. L.J. 385, 385 (1997).

144. *See id.*

ber of weeks, typically seventy-eight weeks or eighteen months, and then paying an additional sum.[145]

When consumers litigate rent-to-own contracts, these contracts shock judges because they often require the consumers to pay a sum much greater than the retail value of the rented item. For example, in one case, a consumer had to pay $1455.90, after sixty-nine weekly payments of $21.10, to own a washer and dryer retailing for only $800.[146] In another case, a consumer had to pay $1643.15, after nineteen monthly payments of $77.96 plus $4.29 (tax), $5.35 (liability waiver fee) and an additional payment of $161.91 to own a washer and dryer retailing for only $600.[147]

Beyond the numbers themselves, the transactions also shock judges because they largely affect low-income consumers. These consumers are too poor to pay cash for the appliance, have a poor credit history barring credit elsewhere, and, after making most of their rental payments, which exceed the retail value of the appliance, have had these appliances taken away when they failed to make the last payment. Courts faced with rent-to-own cases have not assessed the rate of return of the businesses, but have concluded, merely on the face of their charges, that their business practices were unconscionable.[148]

An analysis of rent-to-own businesses suggested that their financial format made them much more profitable than comparable traditional stores selling household goods;[149] therefore, substantive regulation of rent-to-own excessive fees might benefit consumers by lowering their costs without driving rent-to-owns out of business, which would lower consumers' opportunities as well. Unfortunately, a similar assessment of litigation financing firms cannot be performed because, unlike the largest rent-to-own businesses, they are privately held and the dozen or so members of the American Litigation Financing Association, an industry trade association, were unwilling to provide information about the interest rate they charge, how they assess risk, how often they do not recover funds advanced or any other information that would allow a realistic assessment about whether or not they are overcharging their borrowers.

D. *Litigation Financing Equalizes Defendants' Insurance*

The above descriptions of a variety of subprime lending situations indicate two differences between them and litigation financing: first, if a home mortgage, a payday loan, a car-title loan or a rent-to-own transaction is predatory, the consumer may be much worse off than if he or she had

145. *See id.*

146. *See* Miller v. Colortyme, Inc., 518 N.W.2d 544, 546 (Minn. 1994).

147. *See* Rent-A-Center, Inc. v. Hall, 510 N.W.2d 789, 791 (Wis. Ct. App. 1993), *rev. denied,* 115 N.W.2d 715 (Wis. 1994).

148. *See, e.g.,* Perez v. Rent-A-Center, Inc., 892 A.2d 1255, 1275 (N.J. 2006); Green v. Continental Rentals, 678 A.2d 759, 766 (N.J. Super. Ct. 1994).

149. *See* Martin & Huckins, *supra* note 143, at 415-17.

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never engaged in the transaction at all; second, in all these situations an unsophisticated consumer can be taken advantage of by the professional lender. Neither is the case with litigation financing. Moreover, in litigation financing situations, there are other potential villains, the defendants in the underlying lawsuits and their insurance companies, who may do much greater harm to plaintiffs/borrowers who do not have access to litigation funding. Defendants and their insurers may deliberately delay,[150] causing plaintiffs without resources to accept unreasonably low settlement offers. Furthermore, plaintiffs may be disadvantaged by the money defendants and their insurers can expend on experts and other legal support. For example, one estimate has the tobacco industry spending $600 million in attorneys' fees in 1996 alone to defend itself in lawsuits, but there is no judicial or legislative outrage about the fairness of this expense or the right of defense attorneys to earn that much money.[151] Insurance companies act as litigation funders for defendants, and they charge as much as the market will allow. It seems only fair for plaintiffs also to have access to financing to pursue their lawsuits. Because their funders will get paid only if the plaintiffs win, it is highly unlikely that this kind of arrangement will encourage frivolous lawsuits.

IV. A Reasonable Rate of Return

So then, the goals for litigation financing should be (1) to level the playing field between wealthy corporate defendants and poor plaintiffs, and (2) to allow litigation financing firms to earn enough of a return so they will stay in business and others will enter the industry, but not so much that they gouge plaintiffs who might be taken advantage of despite their access to legal advice. Although financial information is not available for most litigation financing firms because they are privately held, analogies can be made to other industries in considering a reasonable rate of return.

A. *Regulated Industries*

Determining a fair rate of return for regulated industries has always involved significant problems.[152] This is true, in part, because the U.S.

150. *See, e.g.*, Editorial, *GOP, Business Want to "Own" Justice in Ohio*, DAYTON DAILY NEWS, Mar. 31, 2003, at A10; Abraham Fuchsberg, *Eliminating Delay in Tort Cases*, N.Y. L.J., June 26, 1989, at 2; Michael Horowitz & Jeffrey O'Connell, *Tort Reform "Rapid Recovery,"* LEGAL TIMES, June 5, 1995, at 26.

151. *See, e.g.*, STEPHANIE MENCIPER, BLOCKING THE COURTHOUSE DOOR—HOW THE REPUBLICAN PARTY AND ITS CORPORATE ALLIES ARE TAKING AWAY YOUR RIGHT TO SUE 79 (2006); Stanley M. Chesley, *Plaintiffs' Attorney Perfects Class-Action Strategy*, BUS. INS., Oct. 30, 1997.

152. *See, e.g.*, JAMES C. BONBRIGHT ET AL., PRINCIPLES OF PUBLIC UTILITY RATES, ch. 14 (1988); A. Lawrence Kolbe & William B. Tye, *The* Duquesne *Opinion: How Much "Hope" is There for Investors in Regulated Firms?*, 8 YALE J. ON REG. 113, 140 (1991); Robert J. Gelhaus & Gary D. Wilson, Note, *An Earnings-Price Approach to Fair Rate of Return in Regulated Industries*, 20 STAN. L. REV. 287, 287 (1968).

Supreme Court has stated that the standard for regulatory commissions is a rate that is "just and reasonable," but there is no standard formula for achieving this result.[153] The Court noted that determining just and reasonable rates requires balancing the interests of investors and consumers.[154]

Respect for investor interest means, according to the Court, a return to the equity owner "commensurate with returns on investments in other enterprises having corresponding risks."[155] Moreover, the return "should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital."[156]

Many formulas have been devised to ascertain the desired fair rate of return, but they all require an estimation of the cost of capital, which in turn relies on a great deal of financial information about the company.[157] It was impossible for the courts in *Rancman* and *Fausone* to know that a return of 280% or 200% on the funds advanced in those two cases, respectively, was unreasonable without any financial information about the funders beyond the terms of the specific agreements at issue. Courts and legislatures could arrive at a compensation method that keeps funders in business while protecting consumers, only if funders had to disclose significant information about their enterprises. This information would have to include whether they have borrowed funds, how much and at what rate; how many lawsuits they have funded; how much money they have advanced; how much they have charged for each; what percent of funded suits have yielded a return and the amount returned; how much money was advanced on cases that were ultimately lost; how much time existed between advancing funds and receiving proceeds; and what the firm's expenses were.

In the case of the insurance industry, although there is wide variation among state regulations, all states require that rates be neither excessive nor inadequate, and in most states insurance companies have to justify rate increases they want to impose by filing data on past and projected claims, even though the insurance commissioner may have no real authority over rates.[158] The property/casualty insurance industry had a 15.6% rate of return in the first half of 2005 and 13% in the first half of 2006,

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153. *See* Fed'l Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591, 602 (1944).

154. *See id.* at 603.

155. *See id.*

156. *See id.*

157. *See* BONBRIGHT ET AL., *supra* note 152.

158. *See* Jay Angoff, *The Myth of the Litigation Crisis*, TRIAL, July 2006, at 30 (author is former insurance commissioner of Missouri). States' primary reason for regulating the insurance industry was not consumer protection; it was to protect carriers from federal anti-trust liability under the McCarren-Ferguson Act which provided that it would not apply to the insurance business as long as the business was regulated by state law. *Id.* (citing 15 U.S.C. § 1012(b) (2001)).

peak profits over the last twenty years.[159] Nevertheless, state legislators are being urged to consider liability-limiting legislation that would further increase profits but not decrease rates for consumers.[160] Generally, as long as a carrier can provide some support for a "reasonable" rate of return, state regulators will approve it and allow the carrier to charge premiums high enough to produce that return.[161]

B. *Deregulated Industries*

Many industries have been deregulated in the last twenty years, allowing the market to set their prices. In the late 1970s regulated industries comprised about 17% of U.S. economic output; today it is about 5%.[162] It is interesting to see the results of deregulation in order to decide whether (1) regulating litigation funding fees or (2) eliminating the regulating effect of champerty and usury laws would actually make plaintiffs/borrowers better off.

In the airline industry, for example, after deregulation in 1979, competition increased and average fares fell with advantages for consumers and new entrants into the industry.[163] One study estimated that consumers benefited by about $10 billion annually (in 1977 dollars) from airline deregulation.[164] Similarly, brokerage fees became dramatically lower after the deregulation of the brokerage service industry in 1975 because brokerage firms could then compete on prices.[165] The success of deregulation in the airline and brokerage industries has been attributed to the fragmented, potentially competitive nature of those industries.[166] On the other hand, deregulation of the telecommunications industry has been less successful because of its structurally monopolistic nature.[167]

Litigation financing is clearly fragmented in that it has many small competitors and, by its nature, it discourages concentration. Its barriers to entry are almost nil: (1) financial resources that may be relatively low because many firms advance under $10,000 per plaintiff/borrower, and (2) a

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159. *See* ROBERT P. HARTWIG, INSURANCE INFORMATION INSTITUTE, COMMENTARY ON FIRST HALF 2006 RESULTS (Oct. 2, 2006), *available at* http://server.iii.org/yy_obj_data/binary/762115_1_0/0602%20Commentary.pdf.

160. *See id.*; Angoff, *supra* note 158.

161. *See* Angoff, *supra* note 158.

162. *See* John E. Kwoka, Jr., *Twenty-Five Years of Deregulation: Lessons for Electric Power*, 33 LOY. U. CHI. L.J. 885, 885 (2002).

163. *See, e.g., id.* at 888-89; *see also* GAUTAM GOWRISANKARAN, FED'L RESERVE BANK OF S.F., FRBSF ECONOMIC LETTER: COMPETITION AND REGULATION IN THE AIRLINE INDUSTRY (Jan. 18, 2002), http://www.frbsf.org/publications/economics/letter/2002/el2002-01.html.

164. *See* KENNETH W. COSTELLO & ROBERT J. GRANIERE, THE NATIONAL REGULATORY RESEARCH INSTITUTE 10 (Ohio St. Univ. 1997), http://www.osti.gov/bridge/servlets/purl/308019-ifD0Il/webviewable/308019.PDF.

165. *See id.* at 17.

166. *See Kwoka, supra* note 162, at 887, 889-91.

167. *See id.*

web site. There is also no need for standardization in the industry, and small, local firms may inspire more trust in their clients. Thus, other industry examples suggest that if competition were encouraged by eliminating fears of illegality because of champerty prohibitions and usury ambiguities, it would result in lower fees to plaintiffs/borrowers.

C. *Credit Card Issuers*

For many years commentators have complained that credit card interest rates are too high,[168] but there is little evidence that capping them creates a reasonable rate of return that ultimately benefits consumers. It is easy for lenders to evade usury restrictions, and credit card issuers have done it by instituting annual fees, changing the method by which they calculate interest, bundling other products like insurance with credit cards, and selling customer lists.[169] All these maneuvers put the consumer at a disadvantage. In fact, although consumers seem to be very loathe to pay annual fees, they have not been very interested in credit card interest rates.[170] Moreover, when usury limitations made profitability harder to achieve in the credit card industry, there were fewer new entrants into the business resulting in less competition.[171] Furthermore, issuers were not willing to take on more risky applicants, making low-income consumers the most hurt by caps on rates.[172]

Just as one commentator has concluded that usury limitations on credit cards have had a negative effect particularly on low-income consumers and that as long as the market is competitive, regulation will be more harmful than helpful,[173] one could come to the same conclusion for litigation financing. Many users of litigation financing have also not been particularly interested in the interest rate being charged because the financing, which was not available to them anywhere else, allowed them to pay medical and living expenses while they maintained their lawsuits long enough to receive appropriate resolutions.[174]

D. *Hedge Funds*

The government and the popular press have not been indignant about the returns earned by hedge fund managers, presumably because these managers work for very wealthy individuals who should be able take care of themselves. But as pension funds and other financial organiza-

168. *See, e.g.*, Oren Bar-Gill, *Seduction by Plastic*, 98 Nw. U. L. Rev. 1373, 1374 (2004); Todd M. Finchler, Note, *Capping Credit Card Interest Rates: An Immodest Proposal*, 12 Ann. Rev. Banking L. 493, 493 (1993).

169. Todd J. Zywicki, *The Economics of Credit Cards*, 3 Chap. L. Rev. 79, 151-52 (2000).

170. *See id.* at 120.

171. *See id.* at 161.

172. *See id.* at 162-63.

173. *See id.* at 170-71.

174. *See, e.g.*, Martin, *The Litigation Financing Industry*, *supra* note 14, at 56, 74.

tions holding money for small individual investors become more involved in hedge fund investment, perhaps it is relevant to note the returns for hedge fund managers which do not seem to be viewed as unconscionable or predatory at all. *The New York Times* reported the 2006 earnings for several hedge fund managers: $1.7 billion for James Simons of Renaissance Technologies; $1 billion for Kenneth C. Griffith of Citadel Investment Group; $1 billion for Edward S. Lampert of ESL Investments; and at least $240 million for the other twenty-three top hedge fund earners.[175]

Since their inception in the mid-1940s, hedge funds have generally charged their investors a two percent management fee in addition to twenty percent of investor profits each year, although some charge even more.[176] It is only in the last year or so when average hedge fund return has not been better than the return of a mutual fund tracking the Standard & Poor's 500-stock index that small hedge fund investors have started to question the fees.[177] When investors become dissatisfied with the performance and fees of a hedge fund, they can take their money and put it elsewhere. Litigation financing customers may do the same thing. There is competition for their business, and they have professional advice. If all funders' fees seem high, perhaps they reflect a risk too high for more traditional lenders to advance funds to a borrower with nothing but a pending lawsuit as collateral. Unfortunately, we cannot know for sure if the funders do not disclose any of their financial information.

V. Litigation Financing in Australia and Other Countries: Some Instructive Examples

Because plaintiffs in the United States do not have to pay their defendants' legal expenses if the defendants win, and because plaintiffs in the United States may be able to engage attorneys to represent them on a contingency basis,[178] the issue of plaintiff financing has not been as critical in the United States as in countries where those conditions do not pertain. Therefore, litigation financing has become much more accepted elsewhere, and those experiences could provide some insight for U.S. acceptance and regulation of the litigation financing industry.

In the United Kingdom (UK) and Australia, for example, "access to justice" issues have become more important as the governments seek to reduce the expenses associated with legal aid traditionally provided to poor plaintiffs.[179] In order to keep the courthouse doors open in legal

175. *See* Jenny Anderson & Julie Creswell, *Make Less than $240 Million? You're Off Top Hedge Fund List*, N.Y. TIMES, Apr. 24, 2007, at A1.

176. *See* Matthew Goldstein & Steve Rosenbush, *Hedge Fund Fees: The Pressure Builds*, BUS. WK., May 14, 2007, at 40.

177. *See id.*

178. I.e., no fee if the plaintiff loses; a percentage of the proceeds if the plaintiff wins.

179. *See* Nikki Tait, *Lawyers Test Litigation Funding Waters*, FIN. TIMES, Jan. 5, 2007, at 3.

systems where losers pay winners' legal costs and lawyers generally charge hourly rather than contingent fees, many countries including the UK, Australia, the Netherlands, Belgium, Germany and South Africa have become more amenable to third parties financing lawsuits, typically on a contingency basis.[180]

A. *Australia*

Litigation financing has become an accepted industry in Australia.[181] Unlike the industry in the United States where there are many small firms that typically advance relatively small amounts of money to personal injury plaintiffs,[182] Australian firms generally support commercial plaintiffs with more substantial legal claims.[183] In Australia, there are five litigation funding companies,[184] one of which, IMF (Australia) Ltd., is listed on the Australian Stock Exchange.[185]

IMF went public in 2001, and has grown at a rate of a hundred percent a year.[186] Its portfolio of cases in the beginning of 2007 represented total claims of about A$1 billion.[187] IMF's average case lasts just more than three years, and its typical fee is about thirty percent of the net proceeds of the case plus reimbursement of its costs.[188] The company settles about sixty percent of its cases, abandons about fifteen percent of those it undertakes, and wins about two thirds of the cases that go to trial.[189] IMF limits its investments to cases with a minimum claim of A$2 million, as it views the litigation costs and risks of funding smaller claims commercially

180. *See id.*; *see also* Michael G. Faure et al., *Funding of Personal Injury Litigation and Claims Culture—Evidence from the Netherlands*, 2 UTRECHT L. REV. 1 (2006).

181. *See* Tait, *supra* note 179, at 3.

182. *See* http://www.acsfcorp.com (last visited May 16, 2007); http://www.captran.com (last visited May 16, 2007); http://nationallawsuitfunding.com (last visited May 16, 2007). Advance Cash & Settlement Funding Corp. will advance between $1,000 and $25,000. *See* http://www.acsfcorp.com (last visited May 16, 2007). Capital Transaction Group, Inc. will advance between $1,000 and $20,000. *See* http://www.captran.com (last visited May 16, 2007). National Lawsuit Funding will advance between $500 and $100,000 but most of its advances are under $10,000. *See* http://nationallawsuitfunding.com (last visited May 16, 2007).

183. For example, see *infra* note 190.

184. *See* Tait, *supra* note 179, at 3.

185. *See Welcome to IMF*, http://www.imf.com.au (last visited May 16, 2007). The four others are Hillcrest Litigation Services Ltd., Litigation Lending Services Pty Ltd., Australian Litigation Funding Pty Ltd. and Firmstone & Fell. LAW COUNCIL OF AUSTRALIA, LITIGATION FUNDING—REPORT TO THE STANDING COMMITTEE OF ATTORNEYS-GENERAL 6 (Sept. 14, 2006). The five account for about 95% of all the litigation funding in Australia. *Id.*

186. *See* Virginia Marsh, *Australian Company Pioneers Approach*, FIN. TIMES, Jan. 5, 2007, at 3.

187. *See id.* An Australian dollar is equivalent to approximately $.82 in U.S. dollars.

188. *See id.*

189. *See id.*

untenable.[190] It makes an exception for class actions when a large number of smaller claims may be aggregated.[191] IMF claims that between 2001 and 2006, it has not received a single complaint about fees from its 15,000 clients.[192]

Between 2002 and 2006, its return on capital of about A$30 million has yielded A$8 million in earnings before interest and taxes (EBIT), or about a seven percent per annum return on capital.[193] In Australia during the same period, the major liability insurance carriers had a return on capital of between fifteen and twenty-two percent.[194] It is important to note, when comparing the litigation funding experience in Australia with that in the United States, that Australian funding firms generally finance less risky commercial cases because they view personal injury cases as too uncertain.[195]

Some examples of IMF's return on specific cases are instructive for seeing what is considered a reasonable return for a litigation financing company in Australia. IMF invested A$500,000 in a breach of contract case in August 2005.[196] The case settled in May 2006, and IMF received A$1.9 million.[197] In a case against an accounting firm, IMF invested A$1.45 million in August 2004.[198] The case settled in October 2006, and IMF received A$5.1 million.[199] In a bankruptcy case, IMF invested A$200,000 in June 2003.[200] The plaintiffs won after the court dismissed the defendant's appeal in November 2003, and IMF received A$1 million.[201] Finally, in January 2003, IMF invested A$100,000 in a case involving breach of a fiduciary duty.[202] The case settled in May 2003 after two weeks of hearings, and IMF received A$500,000.[203]

190. *See* John Walker (IMF), *Litigation Funding for Consumers of Civil Justice System Services*, Nov. 1, 2006, at 3, *available at* http://www.imf.com.au/presentations/LitigationFundingForConsumers.pdf.

191. *See id.*

192. *See id.* at 4.

193. *See* LAW COUNCIL OF AUSTRALIA, *supra* note 185, at 6.

194. *See id.*

195. *See id.* at 12.

196. *See* 789 Ten Pty Ltd v. Westpac & Ors, *available at* http://www.imf.com.au/cases.asp?ID=56.

197. *See id.*

198. *See* Geneva Finance v. Horwarth & Horwarth, *available at* http://www.imf.com.au/cases.asp?ID=16.

199. *See id.* (discussing settlement of case)

200. *See* Veremu Pty Ltd. v. Ezishop.Net Ltd., 2003 NSWCA 317 (N.S.W.) (stating facts of case), *available at* http://www.imf.com.au/cases.asp?ID=24.

201. *See id.* (stating resolution of case).

202. *See* Global Med. Imaging Mgmt. Ltd. v. Australian Mezzanine Inv. Ltd., 2003 NSWSC 432 (N.S.W.) (stating facts of case).

203. *See id.* (stating resolution of case).

By the end of 2006, litigation funders in Australia were investing about A$20 million per year to support plaintiffs.[204] IMF estimated that insurance companies in Australia were spending at least A$1 billion to support their insured defendants.[205] About half of the defendants in cases funded by IMF had their defense managed and funded by insurance companies.[206] The managing director of IMF in Australia sees the purpose of litigation funding as providing the same benefits for plaintiffs that the insurance industry provides for defendants.[207] In a typical insurance contract, the insurer agrees to finance any litigation arising out of the subject of the contract.[208] The insurer will also decide how to handle a legal claim, will choose lawyers, and will indemnify the insured.[209] In Australia, litigation funders provide the same services as insurance companies.[210]

In the United States, on the other hand, litigation funders agree not to make any decisions about the lawsuits (other than whether to financially support them in exchange for a contingent fee) and agree not to interfere in the relationship between the plaintiffs/borrowers and their lawyers.[211] In fact, in the United States, litigation funders merely advance money to plaintiffs to use any way they wish; they do not directly fund the litigation at all, a role that is, however, permitted for U.S. attorneys.[212] Furthermore, litigation funders in the United States do not take a percentage of the proceeds of the case. If the plaintiff wins, the funder gets a return of the funds advanced plus one of several specific fees listed in the agreement depending on the length of time between the advance and the completion of the case.

Nevertheless, there has also been a longstanding fear in the United States that litigation financing would strip plaintiffs of their power to control their litigation and would interfere with the relationship between attorney and client.[213] On the other side of a lawsuit it is well-accepted that insurance companies are going to assume control of the litigation for their defendants/insureds. The same rules that protect defendants from being poorly represented by lawyers paid by insurance companies should be able

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204. *See* Walker, *supra* note 190, at 1 (discussing litigation management by funders).

205. *See id.* (same).

206. *See id.* at 5 (observing trends in litigation funding markets).

207. *See* Marsh, *supra* note 186 (exploring litigation funding in Australia).

208. *See* Walker, *supra* note 190, at 1 (explaining litigation management by insurers).

209. *See id.* (noting role of insurers in litigation management).

210. *See id.* (observing similarities between insurers and litigation funders).

211. *See* http://www.lawcash.net/html/plaintiff-faqs.html (last viewed Oct. 25, 2007).

212. *See generally* MODEL RULES OF PROF'L CONDUCT R. 1.8(e) (2003) (stating lawyer may advance court costs and expenses of litigation to client).

213. *See, e.g.*, Gregerson v. Imlay, 10 F. Cas. 1185 (C.C.S.D.N.Y. 1861) (No. 5795); Comment, *Ethics: Client-Attorney Personal Relationship Test*, 4 WM. & MARY L. REV. 217, 222-28 (1963) (discussing perceptions of third party donating funds for lawsuit).

to protect plaintiffs from having litigation funders exert pressure on their lawyers. In the United States, loyalty is an essential element of lawyers' responsibilities to their clients.[214] The Model Rules of Professional Conduct prohibit lawyers from allowing third parties to interfere with their representation of their clients.[215] If the rules work for defendants' lawyers, they should also work for plaintiffs' lawyers.

The Standing Committee of Attorneys-General in Australia noted in a discussion paper that an important consideration for Australian courts in assessing these new litigation financing arrangements has been "access to justice."[216] When defendants have challenged these agreements as being impermissibly champertous, Australian courts during the last decade have not stricken a single agreement, primarily for "access to justice" reasons.[217] In a recent, highly influential opinion, the High Court of Australia noted that litigation funding and class actions may seem "unconventional or horrible" to those practicing law before the doctrines of champerty and maintenance became obsolete.[218] Prohibiting litigation funding and class actions, however, would cause many people with legitimate claims to lose their legal rights to recover because they lack the resources to pursue their claims.[219] In *Campbells Cash and Carry Pty Ltd. v. Fostif Pty Ltd.*,[220] one justice recognized the "importance of not preventing 'humble men' from receiving 'contributions to meet a powerful adversary.'"[221] After this decision, U.S. hedge funds began contacting Austra-

214. *See* MODEL RULES OF PROF'L CONDUCT R. 1.7 cmt. n.1 (2003) ("[L]oyalty and independent judgment are essential elements in a lawyer's relationship to a client"). *See, e.g.*, Twin City Fire Ins. Co. v. Ben Arnold Sunbelt Beverage Co., 336 F. Supp. 2d 610, 615-16 (D.S.C. 2004) (noting that lawyer hired by insurer owes unqualified duty of loyalty to insured); United States v. Daniels, 163 F. Supp. 2d 1288, 1290 (D. Kan. 2001) (noting counsel retained by insurer to represent insured owes duty of loyalty to insured, not insurance carrier); Herbert A. Sullivan, Inc. v. Utica Mut. Ins. Co., 788 N.E.2d 522, 540 (Mass. 2003) (noting lawyer hired by insurer to represent insured owes unqualified duty of loyalty to insured and must always act to protect interests of insured).

215. *See* MODEL RULES OF PROF'L CONDUCT R. 1.8(f) (2003) (describing circumstances in which lawyer can accept compensation from third party for representing client); MODEL RULES OF PROF'L CONDUCT R. 5.4(c) (2003) (stating lawyer "shall not permit a person who recommends, employs or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services").

216. *See* Standing Committee of Attorneys-General, *Litigation Funding in Australia* 10 (2006), http://www.justice.vic.gov.au/wps/wcm/connect/DOJ+Internet/Home/The+Justice+System/Community+Consultation/JUSTICE++Litigation+Funding+Discussion+Paper+(PDF) (noting community concern that justice system should be accessible to everyone).

217. *See id.* at 10-13 (discussing cost of litigation).

218. *See* Campbells Cash and Carry Pty Ltd. v. Fostif Pty Ltd. (2006) 80 A.L.J.R. 1441, 1467 (Austl.).

219. *See id.* at 1467-68 (presenting justification for litigation funding).

220. 80 A.L.J.R. 1441, 1467 (2006) (Austl.).

221. *See id.* at 1493 (quoting Martell v. Consett Iron Co. Ltd. (1955) Ch 363, 386).

lian funding firms about investing in lawsuits.[222] The *Financial Times* has described litigation financing as "a new asset class for adventurous investors."[223]

In an earlier case, the Supreme Court of New South Wales rejected the argument of an individual plaintiff whose case had been funded by a litigation financing firm, but who wanted the court to rescind the financing agreement on the grounds that the firm exerted too much control over the litigation.[224] The court held that the agreement did not infringe on any public policy; it further noted that it was the funding arrangement that enabled the plaintiff to establish a meritorious claim, and therefore, the plaintiff's argument was quite distasteful.[225]

The Law Council of Australia, a professional organization representing about 50,000 lawyers, reported to the Standing Committee of Attorneys-General that litigation financing firms play an important role in making it possible for parties with legitimate legal claims to pursue those claims when the costs of litigation would otherwise make it impossible for them to do so.[226] The Law Council advised that, like insurance premiums, the cost of litigation funds would correspond to the risks of the funders, and should not be controlled by regulation.[227] It also advised that litigation funders should be treated the same as insurance carriers.[228] One commentator in Australia has suggested that the price of funding should be transparent to the plaintiff/borrower, but otherwise should be left to the market.[229] He indicated, however, a current problem in Australia is that there are so few litigation financing firms to create that market.[230] He concluded, nevertheless, that as long as the plaintiff/borrower receives proper advice and is fully informed about the agreement, then a court should not question the terms of the agreement.[231] Depth of the market is not, of course, a problem in the United States where there are at least

222. *See* Paul B. Brown, *Next, a Lawsuit Futures Exchange?*, N.Y. TIMES, Nov. 25, 2006, at C5 (noting hedge funds have contacted litigation funding companies to invest in lawsuits).

223. *Litigation Funding*, FIN. TIMES, Apr. 8, 2007, http://www.ft.com/cms/s/0eb0053e-e5bd-11db-9fcf-000b5df10621.html (discussing litigation funding).

224. *See* Domson Pty Ltd. v. Zhu, 2005 NSWSC 1070 (N.S.W.).

225. *See id.*

226. *See* LAW COUNCIL OF AUSTRALIA: LITIGATION FUNDING-REPORT TO THE STANDING COMMITTEE OF ATTORNEYS-GENERAL 4 (Sept. 14, 2006), http://www.lawcouncil.asn.au/sublist.html?year=2006 (discussing role of litigation financing firms).

227. *See id.* (summarizing Law Council's comments).

228. *See id.* (same).

229. *See* Lee Aitken, *Before the High Court—'Litigation Lending' after* Fostif*: An Advance in Consumer Protection, or a Licence to 'Bottomfeeders'?*, 28 SYDNEY L. REV. 171, 179 (2006) (discussing litigation funding safeguards).

230. *See id.* (noting current problem with market of fund providers).

231. *See id.* at 180 (stating conclusion).

dozens of firms offering financing.[232] In fact, funding opportunities are so numerous that a business, The Funding Exchange, advertises that, with just one application, it will electronically match a funding request with multiple funding sources.[233]

It is important to remember that in Australia, as in the United States, not all litigation funding is for the benefit of impecunious plaintiffs. The financing of lawsuits by third parties also serves as a risk management tool for companies that are willing to give up a share of the proceeds of the litigation in exchange for reducing the downside litigation risks and for getting some of the potential returns up front.[234] In *QPSX Ltd v. Ericsson Australia Pty Ltd (No. 3)*[235] the Federal Court of Australia described the parties as "sophisticated, well resourced commercial actors operating in domestic and international markets for the sale of complex and potentially very lucrative technologies."[236] The court noted that litigation related to such technologies can be very expensive and, therefore, the creation of arrangements that spread the costs of complex commercial litigation and inject efficiencies into the process of enforcing legitimate claims should be welcomed.[237] The court averred that such arrangements are not contrary to the public interest and in general would not compromise the integrity of the court.[238]

B. *The United Kingdom*

In the UK, the Civil Justice Council, an advisory public body responsible for overseeing the modernization of the civil justice system,[239] concluded in April 2007 that litigation funding played an important role in facilitating access to justice and that no new regulations of the industry were necessary.[240] The litigation financing industry is developing in the

232. *See* http://www.google.com/sponsoredlinks?q=litigation+financing&hl=en&start=0&sa=N; http://www.google.com/sponsoredlinks?q=litigation+financing&hl=en&start=10&sa=N; http://www.google.com/sponsoredlinks?q=litigation+financing&hl=en&start=20&sa=N; http://www.google.com/sponsoredlinks?q=litigation+financing&hl=en&start=30&sa=N. A Google search for litigation financing firms reveals at least three dozen with sponsored links.

233. *See* http://www.thefundingexchange.com (last viewed May 24, 2007).

234. *See* Simon Theodore & Jamie Richardson, *Litigation Funding in Australia*, INT'L LEGAL NEWS, July 13, 2006, *available at* http://www.imakenews.com/iln/e_article000617585.cfm?x=b11,0,w (discussing litigation funding in Australia).

235. (No. 3) (2005) FCA 933.

236. *Id.* at 18 (noting sophistication of litigants).

237. *See id.* (identifying positive aspects of litigation financing arrangements).

238. *See id.* (upholding litigation funding arrangements).

239. *See* Civil Justice Council—About Us, http://www.civiljusticecouncil.gov.uk/about/about.htm (describing Civil Justice Council).

240. *See generally* Mayer, Brown, Rowe & Maw LLP, *Litigation & Dispute Resolution Legal Update* 5, May 2007, http://www.mayerbrownrowe.com/london (noting conclusions of Civil Justice Council).

UK because lawyers there cannot charge on a contingency basis.[241] The industry is being funded by hedge funds, insurers and private investors who finance lawsuits in exchange for a share of the proceeds, if there are any.[242]

One litigation funding firm in the UK, IM Litigation Funding ("IM"), was started by a group of lawyers in 2002.[243] IM generally requires a seventy percent chance of success for a case it decides to fund.[244] Its investments start at £50,000,[245] generally using its own funds in combination with those of hedge funds.[246] IM says it has won more than three-quarters of the cases it has funded.[247] When IM wins, it gets between twenty-five and fifty percent of the proceeds of the case in addition to reimbursement of expenses.[248] In its most successful case, it had a return of 1,300% in ten months.[249]

A business publication in the UK reported that the litigation financing market there is still in its infancy, unlike the very active market in Australia, but rumors of hedge fund interest suggest there will be an increase in lawsuits in the near future.[250] UK lawyers are anticipating more lawsuits against auditors by investors in bankrupt companies who, in the past, might have had strong cases but no resources to fight them; however, they are not anticipating an increase in frivolous claims because funders would have to pay for the winners' legal costs which could be a severe penalty.[251]

C. *South Africa*

Three years ago, the Supreme Court of Appeal in South Africa held that a litigation financing agreement was not void or contrary to public policy and that such an agreement between the plaintiff and a third party

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241. *See* Mary Jacoby, *U.K. Auditions Litigation: Regulators Urge U.S.-Style Suits Against Cartels*, WALL ST. J., Jan. 16, 2007, at A12 (exploring lawsuit financing in United Kingdom); *see also* Andrew Hill, *Money for Smart Suits*, FIN. TIMES, Jan. 5, 2007, at 18 (noting that hedge funds are starting to fund litigation in UK).

242. *See* Jacoby, *supra* note 241, at A12.

243. *See* LITIGATION FUNDING, *supra* note 226 (discussing IM Litigation Funding).

244. *See id.* (explaining how IM Litigation Funding decides which cases to invest in).

245. *See Exchange Rates*, http://www.x-rates.com/ (last visited Oct. 13, 2007). A British pound is equivalent to approximately $2.03 in U.S. dollars. *See id.*

246. *See* LITIGATION FUNDING, *supra* note 226 (illustrating company's investment in lawsuits).

247. *See id.* (discussing investments of IM Litigation Funding).

248. *See id.* (same).

249. *See id.* (same).

250. *See* Philip Smith, *Best Practice: Negligence Claims Could Reach New Heights with Litigation Funding Trend*, IT WEEK, Feb. 15, 2007, *available at* http://www.itweek.co.uk/articles/print/2183554 (discussing litigation funding trend in United Kingdom).

251. *See id.* (same).

could not be used by the defendant as a defense.[252] The Court noted South Africa's history of refusing to enforce champertous agreements,[253] but it acknowledged one clear exception: an agreement is enforceable if it is between a person, who in good faith, gives financial aid to a poor potential plaintiff in exchange for an interest in the lawsuit.[254] According to the Court, such an agreement is enforceable because it supports justice and promotes the constitutionally protected freedom of contract.[255]

VI. CONCLUSIONS FOR REGULATION

The foregoing examples of responses to the developing litigation financing industries in other countries suggest that where access to the courts has been more limited than in the United States, because of loser-pays-costs rules and limitations on attorneys' fees, litigation financing is viewed more favorably. It is a way to address an obvious problem without requiring the government to provide more aid for legal expenses. Although the United States has always emphasized an open door policy to the courts as compared to other countries, it is unrealistic to think that, as a practical matter, court doors are sufficiently open to poor plaintiffs with meritorious claims who are opposed by well-financed defendants and their insurance companies. Furthermore, there is no public policy reason to deny businesses the opportunity to share litigation's risks and cash outlay with interested investors in exchange for some of the proceeds. With some new and specific regulation, and the elimination of current potential impediments, it should be possible to preserve the advantages of litigation financing while eliminating abuses. The experiences in other countries support these conclusions.

First, state legislatures should eliminate the champerty doctrine. A few state courts have already done that, but some have instead affirmed the practice.[256] In either case, to encourage the industry and create more competition so that market forces can act to lower fees, legislatures should eliminate the fear among funders that once a case is resolved their

252. *See Price Waterhouse Coopers, Inc. v. Nat'l Potato Co-op. Ltd.* 2004 (6) SA 66 (SCA) at 79-80 (S. Afr.) (holding that third party agreements advancing costs of legal fees are not contrary to public policy).

253. *See id.* ¶ 26 (noting that such agreements were not upheld in past).

254. *See id.* ¶ 27 (describing exception to general prohibition).

255. *See id.* ¶ 44 (holding that third party litigation financing arrangements are consistent with constitutional values).

256. *See, e.g.*, Rancman v. Interim Settlement Funding Corp., 789 N.E.2d 217, 218 (Ohio 2003) (holding that Ohio prohibits champerty and rescinding agreement on that ground); Osprey, Inc. v. Cabana Ltd. P'ship, 532 S.E.2d 269, 277 (S.C. 2000) (holding that champerty cannot be used as defense because there are other devices for eliminating potential evils associated with litigation financing); Saladini v. Righellis, 687 N.E.2d 1224, 1224 (Mass. 1997) (holding that champerty doctrine is no longer law in Massachusetts because there are other devices for eliminating potential evils associated with litigation financing); Johnson v. Wright, 682 N.W.2d 671, 680 (Minn. Ct. App. 2004) (holding that champerty doctrine is in effect in Minnesota).

payback will be a lawsuit asking for a rescission of their agreement. Investors are not going to fund frivolous lawsuits. Businesses looking for investors are disadvantaged by such a paternalistic doctrine that may limit investor interest. In the event of investor overreaching, courts have other tools to police abuses.

Second, state legislatures should define litigation financing as investments, not loans, to eliminate the threat of plaintiffs/borrowers accepting funds and then reneging, arguing usury, on their agreements to pay the stipulated fees out of the proceeds of their lawsuits. They have lawyers to represent their interests in entering into those agreements. Moreover, it should not be a court's task to decide how much risk a funder has undertaken and how small a risk must be to transform an investment into a loan. In addition, it is often the case that price caps hurt just the people they are supposed to protect.

Third, to assure the proper disclosure, transparency and advice to borrowers that will prevent abuses in the industry, state legislatures should adopt a licensing regime for litigation funders that would include data collection about the industry. The licensing system currently being created by the NASD for the CSBS for the mortgage industry could serve as a model.[257] NASD already operates two similar systems for state regulators, one for the securities industry and one for the financial planning and investment advisor industry.[258] A licensing system would provide plaintiffs/ borrowers with information about the funders and discourage predatory funders.[259]

Fourth, litigation funders should have to be licensed, and licensees should be required to comply with the rules set out by the New York Attorney General's Office in an agreement with nine litigation financing firms operating in New York.[260] These rules incorporated the following requirements: all funding contracts should have to use plain, ordinary language with topics clearly divided and captioned.[261] The contracts should clearly contain: (1) the total amount advanced; (2) all fees individually itemized; (3) the total fee as an annualized rate of return; (4) the total

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257. *See Subprime and Predatory Lending: New Regulatory Guidance, Current Market Conditions, and Effects on Regulated Financial Institutions: Hearing Before the Subcomm. on Fin. Inst. and Consumer Credit of the H. Comm. on Fin. Serv.*, 110th Cong. 9 (2007) (statement of Steven L. Antonakes, Mass. Comm'r of Banks, Conference of State Bank Supervisors), *available at* http://www.house.gov/apps/list/hearing/financialsvcs_dem/htantonakes061307.pdf (examining mortgage lending system).

258. *See id.* (same).

259. *See id.* (same).

260. *See Assurance of Discontinuance Pursuant to Executive Law* § 63(15), Att'y Gen. of N.Y., Bur. of Consumer Frauds & Prot., In re Plaintiff Support Services, Inc., Feb. 17, 2005), *available at* http://www.americanlegalfin.com/alfasite2/documents/ALFAAgreementWithAttorneyGeneral.pdf (listing requirements of consumer contracts).

261. *See id.* at 4 (same); *see also* N.Y. GEN. OBLIG. LAW § 5-702 (2007) (requiring use of plain language in consumer transactions).

amount to be repaid, with amounts listed in six-month intervals, including all fees and minimums, if any; (5) a right to cancel within five days of receipt of the advance by returning the advance; and (6) a written certification by the plaintiff/borrower's attorney that the terms of the contract were explained to the plaintiff/borrower.[262]

The outlined regulation would help plaintiff/borrowers choose the best litigation financing arrangement available because all relevant information would be disclosed and explained. It would also enable litigation financing firms to know that their agreements would be enforced by courts. Eliminating uncertainty and discouraging an "outlaw" reputation would increase competition in the industry, which should help lessen costs for plaintiffs/borrowers.

Government should not be so paternalistically protective of people who do not have access to traditional forms of credit that it keeps those people from owning homes, having washers and dryers or pursuing meritorious lawsuits. More widely available credit creates important opportunities for those with a poor credit history or without any credit history at all. Thus, legislatures and courts must recognize that subprime credit is going to be more expensive, because the risks are greater for the lender, and not seek, because of sympathy for subprime borrowers, to compare subprime rates with those of traditional lenders. Doing so will discourage litigation funders,[263] decreasing competition and opportunities instead of expanding them, and forcing plaintiffs with no resources to accept unfairly low settlement offers because they cannot afford to wait for a better offer or to go to trial.

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262. *See Assurance of Discontinuance Pursuant to Executive Law § 63(15)*, *supra* note 260, at 4-5 (listing requirements of contracts).

263. *See, e.g.*, Martin, *supra* note 2, at 96, 96 n.83 (citing CEO of New Jersey litigation financing firm who stopped advancing funds in Ohio after *Rancman* decision).