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Financing Litigation On-Line: Usury and Other Obstacles

Susan Lorde Martin¹

I. INTRODUCTION

Although the idea that “wealth [should not have] the monopoly of justice against poverty”² has been embraced as a basic principle in the legal system of the United States, in practice, a wealthy litigant can often outlast, and win against, a poor opponent. If a plaintiff has a good case but no financial resources to pursue it (and, perhaps, insufficient means to pay medical bills and other living expenses), a plaintiff may have no choice but to forgo the suit or to accept a defendant’s low settlement offer. A plaintiff may not be able to find a lawyer willing to take the case on a contingency fee basis and, even if such an arrangement were available, in most states the lawyer could not provide money for the client’s living expenses.³ Furthermore, traditional lenders have not been willing to extend loans with only potential proceeds of a lawsuit as collateral, judging such loans as too risky.⁴

In the last five years or so, a new financial industry has filled this litigation void.⁵ There are now many small, private firms advertising on the Internet that will give plaintiffs money in exchange for a share

1. Professor of Business Law, Frank G. Zarb School of Business, Hofstra University. A Summer Research Grant from the Frank G. Zarb School of Business supported this research.

2. JEREMY BENTHAM, *Letters I & XII, in IN DEFENCE OF USURY* 1-5, 117-28 (1787).

3. See, e.g., MODEL RULES OF PROF’L CONDUCT R. 1.8(e); Florida Bar v. Rue, 643 So. 2d 1080 (Fla. 1994); *In re Farmer*, 950 P.2d 713 (Kan. 1997); Attorney Grievance Comm’n v. Engerman, 424 A.2d 362 (Md. 1981); Mississippi Bar v. Attorney HH, 671 So. 2d 1293 (Miss. 1995); State ex rel. Oklahoma Bar Ass’n v. Smolen, 837 P.2d 894 (Okla. 1992); Alice L. Hageman, *Neither a Borrower, nor a Lender Be*, available at www.state.ma.us/obcbbo/lender.htm (last visited Mar. 10, 2002). But see Louisiana State Bar Ass’n v. Edwins, 329 So. 2d 437, 445 (La. 1976) (holding that in spite of an attorney’s violating the words of the disciplinary rule that prohibits the advancing of funds to a client, the attorney did not violate “the spirit or the intent of the disciplinary rule . . . by the advance or guarantee . . . to a client (who had already retained him) of minimal living expenses, of minor sums necessary to prevent foreclosures, or of necessary medical treatment”); MONT. RULES OF PROF’L CONDUCT R. 1.8 (providing that “a lawyer may, for the sole purpose of providing basic living expenses, guarantee a loan from a regulated financial institution whose usual business involves making such loans if such loan is reasonably needed to enable the client to withstand delay in litigation that would otherwise put substantial pressure on the client to settle a case because of financial hardship rather than on the merits”).

4. Mike France, *The Litigation Machine*, BUS. WK. ONLINE, Jan. 29, 2001, available at http://www.businessweek.com/2001/01_05/b3717001.htm.

5. *Id.*

of the proceeds of the litigation, if there are any. If the plaintiff loses, the money need not be returned. The reason why this kind of arrangement has only recently become available is that it has been illegal in many states. A third party's support for another's litigation violates the prohibition on champerty. This author has discussed the relationship between the modern champerty doctrine and third party litigation financing in other articles.⁶ What is relevant is that just as the prohibition on champerty is weakening, one court has suggested another theory for disallowing a third party's support for a litigant in exchange for part of the award or settlement.⁷ An Ohio appeals court has held the arrangement to be a loan and not a contingent cash advance and, therefore, void, resulting in the financing company's having "no right to collect . . . any principal, interest or charges."⁸ Strictly speaking, the court found the instant agreements were void because as loans they violated Ohio's Small Loan Act, which requires that those lending money must first obtain a license. Once it declared the agreements void, the court did not have to decide whether the agreements violated the usury statute. Nevertheless, it is clear that if such agreements are loans, they are usurious under the Ohio statute and, under similar circumstances, would be in most other states.

The next section of this article briefly reviews the prohibitions on champerty. In Part III the article outlines the law on usury. Part IV discusses the relationship between usury laws and third party litigation financing. Part V presents the emergence of the new financing firms and their benefits for plaintiffs. Part VI concludes that holding these firms to usury law limits is wrongheaded and disadvantages plaintiffs in their uphill battle against corporate giants. As long as there is full disclosure, plaintiffs, who under the circumstances have access to advice of counsel, should also have access to the funds necessary to pursue their cases against defendants who might otherwise force them to forgo the litigation or to accept much less than their cases are worth. If the plaintiffs lose, they will not have to repay anything at all; if they

6. See Susan Lorde Martin, *Financing Plaintiffs' Lawsuits: An Increasingly Popular (and Legal) Business*, 33 U. MICH. J.L. REFORM 57 (1999-2000); Susan Lorde Martin, *Syndicated Lawsuits: Illegal Champerty or New Business Opportunity?*, 30 AM. BUS. L.J. 485 (1992).

7. *Rancman v. Interim Settlement Funding Corp.*, No. 20523, 2001 WL 1339487 (Ohio Ct. App. Oct. 31, 2001) (unpublished opinion). The Ohio Supreme Court has agreed to hear the appeal of the defendants Interim Settlement Financing (ISF) and Future Settlement Financing (FSF). *Rancman v. Interim Settlement Funding Corp.*, 763 N.E.2d 1184 (2002); E-mail from Richard C. Ashcroft, President, ISF, to Susan Lorde Martin, Professor of Business Law, Frank G. Zarb School of Business, Hofstra University (Mar. 14, 2002) (on file with author).

8. *Rancman*, 2001 WL 1339487, at *4 (citing OHIO REV. CODE § 1321.02).

win, they may be better off despite having to pay back the sum advanced plus a very high premium.

II. CHAMPERTY

Champerty is an ancient doctrine describing an arrangement in which one person, the champertor, agrees to support another in bringing a legal action in exchange for part of the proceeds of the litigation.⁹ Common law, statutory law and public policy have prohibited these arrangements throughout the United States.¹⁰ The prohibition is based on longstanding fears that champertors will encourage frivolous litigation, harass defendants, increase damages, and resist settlement.¹¹ In spite of the fears, however, exceptions to the champerty prohibition have been commonplace because of recognition that without third party support some meritorious plaintiffs would not be able to litigate their claims because they lacked the financial wherewithal.¹² The most notable exception to the champerty doctrine is lawyers' contingency fees. A lawyer's agreement to handle a case in exchange for a percent of the damages recovered, if any, is clearly champertous. Nevertheless, all states in the United States recognize such agreements.¹³ The open court door policy has had a preminent place in the United States, and the contingency legal fee has been viewed as the "poor and middle income person's ticket to justice."¹⁴

A few states do not prohibit champerty and will enforce champertous agreements. New Jersey has never prohibited champerty.¹⁵ In 1997 the Supreme Judicial Court of Massachusetts held in *Saladini v.*

9. See, e.g., Martin, *supra* note 6; Max Radin, *Maintenance by Champerty*, 24 CAL. L. REV. 48, 51 (1935); Y. L. Tan, *Champertous Contracts and Assignments*, 106 L.Q. REV. 656, 657 (1990).

10. See, e.g., Paul Bond, Comments, *Making Champerty Work: An Invitation to State Action*, 150 U. PA. L. REV. 1297, 1333-41 (2002) (providing a summary of champerty law in all fifty states).

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

12. See, e.g., Martin, *Financing Plaintiffs' Lawsuits*, *supra* note 6 and text accompanying notes 126, 132, 137, 155-59.

13. Kenneth A. Ewing, Comment, *Quantum Meruit in Ohio: The Search for a Fair Standard in Contingent Fee Contracts*, 18 U. DAYTON L. REV. 109, 110 & n.4 (1992) (listing statutory and common law approval of lawyers' contingency fees).

14. *Tort Law in New York Today: The Capra Report*, N.Y.S. B.J., Apr. 1999, at 8, 50 (quoting David Vuernick, legal policy director of Citizen Action).

15. See, e.g., *Bron v. Weintraub*, 199 A.2d 625, 630 n.1 (N.J. 1964); *Schomp v. Schenck*, 40 N.J.L. 195 (1878) (noting that doctrines of maintenance and champerty were determined to be "inapplicable" in New Jersey as early as 1792); *Polo v. Gotchel*, 542 A.2d 947, 949 (N.J. Super. Ct. Law Div. 1987); *Hughes v. Eisner*, 72 A.2d 901, 902 (N.J. Super. Ct. Ch. Div. 1950); *Weller v. Jersey City, H. & P. St. Ry. Co.*, 57 A. 730, 732 (N.J. Ch. 1904) (asserting that maintenance and champerty never prevailed in New Jersey as indicated in a "learned and exhaustive opinion" of Chief Justice Beasley in *Schomp v. Schenck*).

*Righellis*¹⁶ that “the common law doctrine of champerty . . . no longer shall be recognized in Massachusetts.”¹⁷ An Arizona court of appeals has noted that the “doctrine of champerty . . . does not apply in Arizona.”¹⁸ However, most states do prohibit champerty in some fashion, for example, by statute in New York;¹⁹ in common law as a contract defense in Ohio;²⁰ and in common law requiring officious intermeddling as a necessary element in Florida.²¹

The litigation support firms on the Internet are clearly engaging in champerty. They are providing funds in exchange for a share of a settlement or verdict. Nevertheless, so far there is no recorded opinion refusing to enforce their agreements on the grounds of champerty. Even in states that prohibit champerty, most have not invalidated an agreement on that basis in recent years, if at all. For example, the Alaska Supreme Court, while still suggesting that its common law prohibition against champerty is in effect, has not enforced it in any recent case where the issue has arisen.²² Similarly, the Supreme Court of Colorado has mentioned common law champerty,²³ but has not in recent years invalidated an agreement on those grounds. Kentucky has a statute that declares void as champertous a contract for the purpose of aiding in the prosecution or defense of a lawsuit in exchange for any part of the thing sued for.²⁴ Nevertheless, Kentucky too has not voided a contract on that ground in recent years. In dicta in 1997²⁵ and 1992²⁶ the Supreme Court of Kentucky suggested that champerty could be used as a defense, but the cases it cited for that proposition were decided in 1895²⁷ and 1909.²⁸ Georgia has a statute providing that contracts contrary to public policy cannot be enforced

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

17. *Id.* at 1224. Barratry is maintenance that promotes groundless judicial proceedings. *See, e.g.*, CAL. PENAL CODE § 158 (West 1991); IDAHO CODE § 18-1001 (Michie 1990); S.D. CODIFIED LAWS § 22-12-1 (Michie 2002).

18. *Landi v. Arkules*, 835 P.2d 458, 464 n.1 (Ariz. Ct. App. 1992).

19. N.Y. JUD. LAW § 489 (McKinney 1999).

20. *See, e.g.*, *Tosi v. Jones*, 685 N.E.2d 580, 583 (Ohio Ct. App. 1996).

21. *Kraft v. Mason*, 668 So. 2d 679, 682 (Fla. Dist. Ct. App. 1996).

22. *See, e.g.*, *Wichman v. Benner*, 948 P.2d 484 (Alaska 1997) (holding that hospital's assignment of its claims in malpractice action did not violate public policy against champerty and maintenance); *Deal v. Kearney*, 851 P.2d 1353 (Alaska 1993) (holding that hospital's assignment of its claims in malpractice action did not violate public policy against champerty and maintenance).

23. *People v. Mason*, 938 P.2d 133 (Colo. 1997).

24. KY. REV. STAT. ANN. § 372.060 (Banks-Baldwin 1998).

25. *Great W. Land Mgmt., Inc. v. Slusher*, 939 S.W.2d 865 (Ky. 1997).

26. *McCullar v. Credit Bureau Sys., Inc.*, 832 S.W.2d 886 (Ky. 1992).

27. *Wemhoff v. Rutherford*, 98 Ky. 91 (1895).

28. *Cumberland Tel. & Tel. Co. v. Maxberry*, 121 S.W. 447 (Ky. 1909).

and includes among those, “contracts of . . . champerty.”²⁹ However, the Georgia Supreme Court has noted that “the delicate and undefined power of courts to declare a contract void as contravening public policy should be exercised with great caution, and only in cases free from substantial doubt.”³⁰ Apparently taking the latter very seriously, Georgia courts have not invalidated any contracts as violative of the statutory prohibition against champerty.

Maryland has a criminal statute, with a penalty of incarceration for one year and a fine of \$1000, which prohibits a person from soliciting, for personal gain, another person to sue or retain a lawyer to represent the other person in a lawsuit.³¹ There has not, however, been any reported case in which a violation of the statute was prosecuted.

Thus, prohibitions against champerty would not seem to be much of a deterrent to litigation finance firms; however, while this legal obstacle may be diminishing, another has just emerged as a significant barrier if upheld. Those who analyze litigation financing have generally accepted the notion that usury laws did not apply to the arrangements – until an appellate court in Ohio held otherwise.

III. USURY

Usury is commonly defined as “the act or practice of lending money at a rate of interest that is excessive or unlawfully high.”³² The term has been used and the practice prohibited for thousands of years: in ancient Mesopotamia and Rome, in medieval England, in eighteenth century Asia.³³ Throughout history, money lending at any interest rate has been treated with opprobrium because of religious or moral beliefs³⁴ and, perhaps in part, due to anti-Semitism.³⁵

The history of usury laws in the United States reflects the mixed opinions about their value. The colonies and then the states enacted usury statutes to protect consumers from the overreaching acts of creditors.³⁶ However, in the mid to late nineteenth century, England

29. GA. CODE ANN. § 13-8-2(a)(5) (1998).

30. *Foster v. Allen*, 40 S.E.2d 57, 59 (Ga. 1946).

31. MD. CODE ANN., BUS. OCC. & PROF. § 10-604(a) (1998).

32. WEBSTER'S NEW TWENTIETH CENTURY DICTIONARY OF THE ENGLISH LANGUAGE UNABRIDGED 2013 (2d ed. 1980).

33. JEREMY BENTHAM, *Letter II*, in *IN DEFENCE OF USURY* (1787); Paul G. Hayeck, *An Economic Analysis of the Justifications 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 & FINANCIAL HISTORY* 175 (1998).

34. Hayeck, *supra* note 33, at 253.

35. JEREMY BENTHAM, *Letter X*, in *IN DEFENCE OF USURY* (1787).

36. Hayeck, *supra* note 33, at 256-57 (e.g., Massachusetts in 1661, Maryland in 1692, Virginia in 1730).

and a number of states in the United States repealed their usury statutes; economists had convinced them that credit markets are competitive and that usury laws inhibit economic growth and undermine efficiency.³⁷ By the early twentieth century most states again had usury laws that limited interest rates to between six and twelve percent, and by 1965, every state had some kind of usury law limiting interest rates to between six and twenty percent.³⁸ Today, most states, at the encouragement of consumers groups, have statutes setting interest rate limits and prohibiting usury.³⁹ Most states, however, exempt corporations from their usury statutes, permitting them to borrow at rates higher than the legal limit.⁴⁰ Most states also have exemptions for some consumer loans.⁴¹ Critics have argued that the variety of usury laws across and within individual states makes no logical or economic sense and is merely the result of dedicated interest group lobbying.⁴²

In most states, the elements of usury are: (1) an agreement to lend money; (2) the borrower's absolute obligation to repay with repay-

37. Hayeck, *supra* note 33, at 253-56. For example, in 1869 the Texas legislature amended the Texas Constitution to eliminate usury laws. When credit abuses arose, the legislature amended the Constitution again to reinstate usury laws. *In re Coxson*, 43 F.3d 189, 191 n.2 (5th Cir. 1995).

38. Eric A. Posner, *Contract Law in the Welfare State: A Defense of the Unconscionability Doctrine, Usury Laws, and Related Limitations on the Freedom to Contract*, 24 J. LEGAL STUD. 283, 313 (1995).

39. See, e.g., Ala. Code § § 8-8-2, 5-19-3 (2002); ALASKA STAT. § 45.45.010 (Michie 2001); ARIZ. REV. STAT. § 13-2208 (2001); ARK. CODE ANN. § 13 (Michie 2001); CAL. CONST. CODE art. XV, § 1 (West 2002); COLO. REV. STAT. § 18-15-104 (2001); DEL. CODE ANN. tit. 6, § 2304 (2001); FLA. STAT. chs. 516.031, 687.02 (2001); GA. CODE ANN. § 7-4-2 (2001); HAW. REV. STAT. § 478-2 (2001); ILL. COMP. STAT. 5/39-1 (2001); IND. CODE § 24-4.5-1-102 (2001); IOWA CODE § 535.2 (2001); KAN. STAT. ANN. § 16a-2-401 (2001); KY. REV. STAT. ANN. § 360.010 (Banks-Baldwin 2001); LA. CIV. CODE ANN. art. 2924 (West 2001); ME. REV. STAT. ANN. tit. 9-A, §§ 1-102, 2-201 (West 2001); MD. CODE ANN., COM. LAW § 12-102 (2001); MASS. GEN. LAWS ch. 271, § 49 (2001); MICH. COMP. LAWS § 438.41 (2001); MINN. STAT. § 334.03 (2001); MISS. CODE ANN. § 75-17-1 (2002); MO. REV. STAT. § 408.060 (2001); MONT. CODE ANN. § 31-1-108 (2001); NEB. REV. STAT. § 45-109 (2001); N.J. STAT. ANN. § 2C:21-19 (West 2001); N.M. STAT. ANN. § 56-8-9 (Michie 2001); N.Y. GEN. OBLIG. LAW § 5-501(1) (McKinney 2001); N.C. GEN. STAT. § 24-2 (2001); N.D. CENT. CODE § 12.1-31-02 (2001); OHIO REV. CODE ANN. § 2905.22 (West 2001); OKLA. STAT. tit. 15, § 272 (2001); PA. CONS. STAT. ANN. § 4806.3 (West 2001); R.I. GEN. LAWS § 6-26-2 (2001); S.C. CODE ANN. § 31-13-210 (Law. Co-op. 2001); S.D. CODIFIED LAWS § 54-3-16 (Michie 2001); TENN. CODE ANN. § 7 (2001); TEX. FIN. CODE ANN. §347.110 (Vernon 2001); UTAH CODE ANN. § 76-6-520 (2001); VT. STAT. ANN. tit. 8, § 2233 (2001); VA. CODE ANN. § 6.1-330.55 (Michie 2001); WASH. REV. CODE § 19.52.005 (2001); W. VA. CODE § 47-6-6 (2001); WIS. STAT. § 138.06 (2001). *But see* IDAHO CODE §§ 28-22-108 through 28-22-112 (2000) (repealing the usury statute).

40. See Hayeck, *supra* note 33, at 274, 276 n.112 (noting that forty-three states have corporate exemptions).

41. See Hayeck, *supra* note 33, at 274, 276 n.113 (noting that thirty states have exemptions for FHA-insured home mortgage loans).

42. See, e.g., James J. White, *The Usury Trompe L'Oeil*, 51 S.C. L. REV. 445, 446 (2000).

ment not contingent on any other event or circumstance; (3) a greater compensation for making the loan than is allowed under a usury statute or the State Constitution; and (4) an intention to take more for the loan of the money than the law allows.⁴³ It is the second element that is relevant to this discussion of litigation financing. That element means that if a debt is contingently repayable, there can be no usury. The Supreme Court of Arizona has used the following as an example of a debt that is contingently repayable: "Borrower says to lender: Lend me \$10 to bet on a horse race, and if the horse wins, I promise to pay you \$15 tomorrow; if the horse loses, you get nothing."⁴⁴ Unlike the majority of states, in Texas "a contract is usurious when there is any contingency by which the lender may get more than the lawful rate of interest."⁴⁵ Thus, under Texas law where the Constitution sets the maximum rate of interest at ten percent per year, the lender in the horse race example would be guilty of usury. In most states the loan would not be usurious because of the risk of losing the entire ten dollars lent. The Supreme Court of Pennsylvania noted in 1888, "It is settled law that when the promise to pay a sum above legal interest depends upon a contingency, and not upon the happening of a certain event, the loan is not usurious."⁴⁶ The Restatement of Contracts explains that "[u]sury laws do not forbid the taking of business chances in the employment of money."⁴⁷ Thus, when a lender takes a chance on losing the principal entirely, receiving a return greater than the usury law allows is not prohibited.⁴⁸ However, the Restatement also notes that "[i]f the probability of the occurrence of the contingency on which diminished payment is promised is remote, or if the diminution should the contingency occur is slight as compared with the possible profit to be obtained if the contingency does not occur, the transaction is presumably usurious."⁴⁹ In addition, courts have held that the risk

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

44. *Britz v. Kinsvater*, 351 P.2d 986, 991 (Ariz. 1960).

45. *Shropshire v. Commerce Farm Credit Co.*, 30 S.W.2d 282, 285 (Tex. 1930), *cert. denied*, 284 U.S. 675 (1931).

46. *Truby v. Mosgrove*, 11 A. 806, 807 (Pa. 1888).

47. RESTATEMENT (FIRST) OF CONTRACTS § 527 cmt. a, app. (2002).

48. See *Britz*, 351 P.2d at 991; 45 AM. JUR. 2D *Interest and Usury* § 133 (1999); 91 C.J.S. *Usury* § 25 (1955); 14 WILLISTON ON CONTRACTS § 1692 (3d ed. 1972).

49. RESTATEMENT (FIRST) OF CONTRACTS § 527 cmt. a, app. (2002).

must be substantial and there must be some greater hazard than the mere failure of the borrower to repay.⁵⁰

In general, courts do not favor a finding of usury. In New York, "usury must be proved by clear and convincing evidence as to all its elements and will not be presumed."⁵¹ In most states the burden of proof is on the party asserting a usury claim.⁵² Furthermore, when an agreement can be construed in two ways, one lawful and the other usurious, in the absence of evidence "requiring" a usury conclusion, courts generally will interpret the agreement as being lawful.⁵³

Given its recognition of the contingency exception in defining loans for the purpose of usury law, the decision of the Ohio appellate court finding two companies, that provided funds to a plaintiff pending settlement of her personal injury case, guilty of making loans was quite unusual. The decision is noteworthy because it may have an effect on the new litigation financing industry and eliminate a new opportunity to level the playing field between a poor plaintiff and a rich defendant.

IV. LITIGATION FINANCING AND THE USURY LAW

The plaintiff in the Ohio case had been injured in a car accident with an uninsured drunk driver.⁵⁴ Against the advice of her attorney, while the accident litigation was pending, Rancman, the plaintiff, entered into two contracts to receive a total of \$6,000 from Future Settlement Funding Corporation (FSF) and another contract to receive \$1,000 from Interim Settlement Funding Corporation (ISF).⁵⁵ Rancman testified that she knew the terms of the contracts.⁵⁶ In the FSF agreement, Rancman agreed to pay FSF \$16,800 out of the proceeds of her accident litigation if the case settled in twelve months, \$22,200 if it settled in eighteen months, or \$27,600 if it settled in twenty-four months.⁵⁷ If she recovered nothing, then she would owe

50. See, e.g., *Thomassen v. Carr*, 58 Cal. Rptr. 297, 301 (Ct. App. 1967); *Diversified Enters., Inc. v. West*, 141 So. 2d 27, 30 (Fla. Dist. Ct. App. 1962); *Dublin v. Veal*, 341 S.W.2d 776, 777-78 (Ky. 1960); *Olwine v. Torrens*, 344 A.2d 665, 667 (Pa. Super. Ct. 1975).

51. *Fried v. Bolanos*, 629 N.Y.S.2d 538, 539 (App. Div. 1995).

52. See, e.g., *Ditmars v. Camden Trust Co.*, 92 A.2d 12 (N.J. 1952).

53. See, e.g., *Dopp*, 927 F. Supp. at 82; *Lindsey v. Campbell*, 282 P.2d 948 (Cal. Dist. Ct. App. 1955).

54. *Rancman v. Interim Settlement Funding Corp.*, No. 20523, 2001 WL 1339487, at *1 (Ohio Ct. App. Oct. 31, 2001).

55. *Id.*

56. *Id.* at *3.

57. Security Agreement between Roberta Rancman and Future Settlement Funding Corp. (Apr. 27, 1999) (on file with the author).

nothing.⁵⁸ In the ISF agreement, Rancman agreed to pay \$2,800 contingent upon her recovering in the accident litigation.⁵⁹

Rancman made her accident claim against State Farm Insurance under the uninsured motorist provision of her husband's insurance policy.⁶⁰ At the time, there was a question about whether or not she was covered under the policy because she was separated from her husband.⁶¹ Nevertheless, State Farm did make a settlement offer of \$35,000.⁶² Whether the offer was made before or after Rancman's agreement with FSF is unclear and was not pursued by the Ohio appellate court, although it is clear that the offer was made before her agreement with ISF.⁶³ Rancman eventually settled the claim with State Farm for \$100,000.⁶⁴ She then sued FSF and ISF seeking *inter alia* a declaratory judgment that the loan agreements were void because they were usurious.⁶⁵

The magistrate conducting the usury trial proposed that the contracts did violate the usury interest law, as well as the Small Loan Act, so FSF and ISF should not recover anything or, in the alternative, the proper repayment amount would be the principal plus eight percent annual interest.⁶⁶ The trial court decided on the latter, and all the parties appealed.⁶⁷ The appellate court held that the agreements were not contingent cash advances as argued by FSF and ISF, but were loans.⁶⁸ The court came to this conclusion, at least in part, because of the testimony of the president of ISF. He testified that in deciding to advance funds, he looks for a variety of low-risk indicators which were present in Rancman's case: (1) a skilled attorney; (2) full access to the litigation file; (3) client not liable for the accident; (4) serious damage to vehicle; (5) "bright blood" injuries; (6) medical bills (valuing a personal injury case at two and a half to six times the medical bills excluding physical therapy and chiropractic services); and (7) the value of comparable injuries as determined by a jury verdict

58. Schedule A: Capital Advance Agreement executed by Roberta L. Rancman (Apr. 29, 1999) (on file with the author).

59. Transfer and Conveyance of Proceeds and Security Agreement between Roberta Rancman and Interim Settlement Funding Corp. (Sept. 17, 1999) (on file with the author).

60. *Rancman*, 2001 WL 1339487, at *1 n.1.

61. *Id.*

62. *Id.* at *3.

63. *Id.*

64. *Rancman*, 2001 WL 1339487, at *1.

65. *Id.*

66. *Id.*

67. *Id.*

68. *Rancman*, 2001 WL 1339487, at *2.

database.⁶⁹ The appellate court concluded that there was no real probability that State Farm would not pay Rancman,⁷⁰ and, therefore, the agreements were loans because there was no contingency. The court noted that the lowest possible interest rate on the FSF contract was 280%, and the interest on the ISF contract was 180%.⁷¹

This is the first case where a litigation funding company has been found guilty of violating a statute in connection with making a 'loan'. The decision suggests that the agreement in the horse race example above might be usurious if the borrower had done his homework and determined that one horse and its jockey were consistent winners, while the others were consistent losers. The better the borrower was at evaluating horses and jockeys, the more likely the agreement would be usurious; however, one could never be sure about the winner and that's why they run the race (or, as they say in other professional sports where one team is clearly overmatched by its opponent, that's why they play the game). In any particular race or game, one cannot be sure of the outcome. The same is true in litigation: if the outcome could be known for sure, there wouldn't be a case. The loser would not waste its time and money litigating, but would pay what it owed at the beginning. More accurately, if there were a level playing field, there wouldn't be a case. In many cases, however, a well-financed defendant, like State Farm, can afford to proceed with the litigation and to delay in the hopes that a plaintiff without resources, like Rancman, will be forced to give up the lawsuit, receiving nothing or much less than the case was worth.⁷² As a general matter, defendants rarely concede liability.⁷³

If the Ohio court was right that there was no real contingency in the Rancman agreements, then one would expect that she would have had her choice of traditional lenders to lend her the money she needed for living expenses while her litigation with State Farm was ongoing. However, it is well known that traditional lenders will not use a pending lawsuit as collateral for a loan because they deem it too risky.

69. *Id.* at *2-3.

70. *Id.* at *3.

71. *Id.* at *1.

72. See, e.g., Jean Hellwege, *David v. Goliath Revisited: Funding Companies Help Level the Litigation Playing Field*, TRIAL, May 1, 2001, at 14 (quoting Stephen Gillers, ethics expert and professor of law at NYU School of Law).

73. Elihu Inselbuch, *Contingent Fees and Tort Reform: A Reassessment and Reality Check*, 64 LAW & CONTEMP. PROBS. 175, 185 (2001).

V. LITIGATION FINANCE FIRMS AND LEVELING THE PLAYING FIELD

The reasoning of the Ohio appellate court parallels that of critics of lawyers' contingent fees. Those critics argue that a contingent fee is justified only when there is a real contingency, that is, where there is an actual risk of no recovery.⁷⁴ They complain that lawyers enter into contingency fee agreements without considering the likelihood of recovery, even in situations where non-recovery is not a possibility.⁷⁵ On the surface these arguments would seem to be those of consumer groups seeking to reduce fees for poor plaintiffs, however, that is not the case. Business groups have raised the alarm over contingent fees, and more recently over litigation funding companies.⁷⁶

They claim that contingent fees encourage frivolous lawsuits and create windfalls for lawyers.⁷⁷ In focusing on plaintiffs' lawyers, however, these claims ignore the benefits contingent fees and litigation funding provide to plaintiffs vis-à-vis wealthy business defendants.⁷⁸ As Marc Galanter has noted about contingent fee criticism, "[M]easures to protect claimants against their lawyers' misbehavior may impair their ability to contend with the defendants. Reducing the incentives for plaintiffs' lawyers may reduce investments in lawyering for plaintiffs and thus increase the disparities [between plaintiffs and defendants]."⁷⁹ Another commentator has said that "[l]imiting contingency fee arrangements without limiting the amount of money that corporations can spend on their defense is one-sided. . . . Proposals which limit contingency fees affect only one set of players in the civil justice system — consumers."⁸⁰

Similarly, protecting plaintiffs against litigation funding companies may actually increase the advantage defendants enjoy over plaintiffs without resources. Plaintiffs have access to the advice of counsel regarding agreements with funding companies. Thus, they are not mere

74. See, e.g., Lester Brickman, *Contingent Fees without Contingencies: Hamlet without the Prince of Denmark?*, 37 UCLA L. REV. 29, 30 (1989); Grant P. DuBois, *Modify the Contingent Fee System*, 71 A.B.A. J., Dec. 1985, at 38.

75. *Attorney Fees—Foundation Asks FTC to Restrain Use of Contingent Fee Agreements—In Re Washington Legal Foundation Proceeding*, 14 No. 6 Andrews Tobacco Indus. Litig. Rep. 6 (1999).

76. George Steven Swan, *Economics and the Litigation Funding Industry: How Much Justice Can You Afford?*, 35 NEW ENG. L. REV. 805, 833 (2001).

77. Marc Galanter, *Anyone Can Fall Down a Manhole: The Contingency Fee and Its Discontents*, 47 DEPAUL L. REV. 457, 458 (1998).

78. See *id.* at 469.

79. *Id.*

80. Daniel J. Capra, "An Accident and a Dream:" *Problems with the Latest Attack on the Civil Justice System*, 20 PACE L. REV. 339, 391 (2000).

dupes being taken advantage of by experienced business people. It may make financial sense for plaintiffs to risk paying a large fee, plus the principle advanced, in order to have the wherewithal to withstand the delaying tactics of a recalcitrant defendant.

In Rancman's case, she decided to enter into the agreements with FSF and ISF against her lawyer's advice.⁸¹ After Rancman took the money which, perhaps, allowed her to wait the six or seven months between State Farm's \$35,000 and \$100,000 offers for settlement, the Ohio court granted her a windfall because it declared the agreements subject to a statute about loans. If Rancman had been able to get the money as a loan from a traditional and less expensive source, presumably she would have done so. The money was not available elsewhere because no traditional lender was as sure as the Ohio court that Rancman would have the money to pay back a loan.

FSF and ISF are but two of the growing number of litigation finance firms. Until now, the primary legal problem these firms have had is getting around prohibitions on champerty. They were quite confident that the contingent nature of their agreements kept them from violating usury laws.⁸² Although *Rancman*, an unpublished opinion of an Ohio appellate court, may not be the harbinger of court decisions holding these agreements to be usurious, how these firms respond may depend on the exact nature of their businesses and where they and their customers are located. The chief executive officer of a New Jersey company has said that her firm is no longer making advances in Ohio and no one else will either.⁸³ She was also not making advances in Florida because she believed the *Rancman* case had stopped the Florida Bar Association from issuing an ethics opinion it had prepared endorsing the use of litigation financing firms.⁸⁴

The Florida Bar Board of Governors did, in fact, approve the ethics opinion on March 15, 2002, which reads:

An attorney may provide a client with information about companies that offer non-recourse funding and other financial assistance in exchange for an interest in the proceeds of the client's case if it is in the client's interests. The attorney may provide factual information about the case to the funding company with the informed consent of

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

82. See Hellwege, *supra* note 72, at 14 (quoting Al Cone, founder of Advance Settlement Funding).

83. E-mail from Sherry L. Foley, CEO and General Counsel, American Asset Finance, LLC to Susan Lorde Martin, Professor of Business Law, Frank G. Zarb School of Business, Hofstra University (Mar. 14, 2002) (on file with author).

84. *Id.*

the client. Although the attorney may honor the client's valid written assignment of a portion of the recovery to the funding company, the attorney may not issue a letter of protection to the funding company.⁸⁵

The Florida Bar Ethics Committee specifically made "no comment on the legality of these transactions," citing *Rancman*, and noting that "[i]f the transactions are illegal, an attorney must not participate in the transaction in any way."⁸⁶ The Committee emphasized earlier opinions that prohibit attorneys from personally lending money, either directly or indirectly through an attorney-funded nonprofit corporation, to clients in connection with pending litigation.⁸⁷ The Committee also asserted that "[t]he Florida Bar discourages the use of non-recourse advance funding companies," and that an attorney may tell clients about them only if the attorney also discusses with clients the costs and benefits of entering into arrangements with these companies.⁸⁸ Most states that have issued ethics opinions on litigation financing firms have concluded that an attorney may tell clients about such firms and may provide information to the firm at the client's request.⁸⁹

The LawFinance/group, based in San Francisco, describes itself as the creator of the business of litigation financing.⁹⁰ Since 1994 it has been funding, with amounts ranging from under \$100,000 to over four million dollars, plaintiffs who have won money judgments that are being appealed.⁹¹ The company is also willing to fund other litigation situations.⁹² This organization is unusual in that it lists on its web site the panel of lawyers it uses for advice about the selection and evaluation of cases to fund.⁹³ Among those on a long list, which is organized according to state, are well known lawyers in national firms as well as a retired judge.⁹⁴ The Ohio opinion would suggest that the more

85. Fla. Bar Ass'n, Ethics Op. 00-3 (2002).

86. *Id.*

87. *Id.*

88. *Id.*

89. See, e.g., Ariz. Bar Ass'n, Formal Op. 91-22 (1991); N.Y.S. Bar Ass'n, Formal Op. 666 (1994); Philadelphia Bar Ass'n, Formal Op. 91-9 (1991); Ohio Bar Ass'n, Ethics Op. 94-11 (1994); Va. Bar Ass'n, Ethics Op. 1155 (1988).

90. LawFinance/group Inc., *Our Mission*, at <http://www.lawfinance.com/pages/mission.cfm> (last visited Feb. 25, 2002).

91. LawFinance/group Inc., *Case Histories/Articles*, at <http://www.lawfinance.com/pages/cases.cfm> (last visited Feb. 25, 2002).

92. LawFinance/group Inc., *Our Products*, at <http://www.lawfinance.com/pages/products.cfm> (last visited Feb. 25, 2002).

93. LawFinance/group Inc., *Our Products*, at <http://www.lawfinance.com/pages/panel.cfm> (last visited Feb. 25, 2002).

94. *Id.*

skilled this panel in determining the value of a case, the more likely LawFinance/group is violating California usury law; the more incompetent the evaluators, the greater the firm's risk of loss and, therefore, the more likely the fees for the cash advance are within the law, no matter how large they are. On its web site, LawFinance/group gives examples of four cases it has funded.⁹⁵ Three of the cases resulted in wins for the plaintiffs; one resulted in a loss to LawFinance/group of the \$70,000 it advanced to the plaintiff. As long as a financing company can show that it does lose money on some cases, that should be enough to demonstrate that there really is a contingency when it advances funds with the prospect of not getting them back if plaintiffs are unsuccessful in their litigation. On the other hand, the chief executive officer of another funding company, ExpertFunding.com, has said that only two percent of the cases his company has funded have been losers.⁹⁶ After *Rancman*, it is likely that the officers of these companies will be just as reluctant to publish their ratios of winners to losers, as they are to discuss their fees. Would a court consider a two percent chance of loss sufficient to deem the financing agreement contingent, or is that chance not a substantial enough risk?

Litigation funding firms are reticent on the subject of the fees that they charge, indicating that the amount varies depending on the particular facts of each individual case. Thus, it is hard to know whether the percentages cited in *Rancman*, 280% and 180%, exemplify those in the industry in general.⁹⁷ For example, for the three winning cases LawFinance/group discusses on its web site, the amount advanced is indicated, but the amount the firm got back is not. A lawyer in Florida has reported that a funding company approached a client with an offer to advance \$8,000 for a return payment, if the client's case was successful, of \$25,000.⁹⁸ One writer has noted that funding companies commonly receive gains of a hundred percent or more.⁹⁹ Another has said that lenders can triple their investment.¹⁰⁰ Nevertheless, there are many anecdotal stories of clients happy to pay these fees. One such client is a woman who became a quadriplegic when a Firestone tire blew out on her Ford Bronco.¹⁰¹ While she waited for her case to

95. *Supra* note 57.

96. Mike France, *The Litigation Machine*, BUS. WK. ONLINE (Jan. 29, 2001), available at http://www.businessweek.com/2001/01_05/b3717001.htm?scriptFramed.

97. *Rancman*, 2001 WL 1339487, at *1.

98. See Hellwege, *supra* note 72, at 14.

99. *Id.*

100. Mike France, *The Litigation Machine*, BUS. WK. ONLINE (Jan. 29, 2001), available at http://www.businessweek.com/2001/01_05/b3717001.htm.

101. *Id.*

go to trial, Providence Inc. advanced \$5000 a month to her family in exchange for their agreeing to repay twice that amount if the suit is successful.¹⁰² With a suit potentially worth in the tens of millions of dollars, the plaintiff, her family, and their lawyer thought the financing agreement was a good deal because it provided for living and medical expenses, so that they were not forced to settle for much less than they thought their case was worth.¹⁰³ At the time they entered into the agreement with Providence, Firestone and Ford were denying liability.¹⁰⁴ That would certainly seem to indicate a real contingency, but in *Rancman*, the Ohio court did not indicate whether State Farm's first settlement offer preceded the first financing agreement and initially there was a real question about whether State farm owed anything at all.¹⁰⁵

Given the disadvantage of plaintiffs without resources when they are up against wealthy corporate defendants, it was very unwise for the Ohio court to stretch the state's law about loans to fit around the litigation financing situation. When traditional lending institutions will not get into this business because they deem it too risky, it is reasonable to assume that the chance of loss is real. Furthermore, there are now so many litigation financing companies that market forces should operate to keep their fees reasonable. Among those readily available to anyone with access to the Internet, in addition to those already mentioned in this article, are Advance Cost & Settlement Funding Corp. in Pennsylvania and Florida,¹⁰⁶ American Asset Finance LLC in New Jersey,¹⁰⁷ Capital Transaction Group, Inc.,¹⁰⁸ Case Funding Network,¹⁰⁹ Lawsuit Funding.com,¹¹⁰ ExpertFunding.com,¹¹¹ HSAC Funding of Nevada,¹¹² Lawsuit Financial, LLC in Michigan,¹¹³ National Lawsuit Funding in Pennsylvania,¹¹⁴ Plaintiff Support Ser-

102. *Id.*

103. *Id.*

104. Mike France, *The Litigation Machine*, BUS. WK. ONLINE (Jan. 29, 2001), available at http://www.businessweek.com/2001/01_05/b3717001.htm.

105. *Rancman*, 2001 WL 1339487, at *1 n.1.

106. <http://www.acsfcorp.com/> (last visited Feb. 25, 2002).

107. <http://www.amasset.com/> (last visited Feb. 25, 2002).

108. <http://www.captran.com/> (last visited Jan. 25, 2001).

109. <http://www.CaseFunding.com/> (last visited Feb. 25, 2002).

110. <http://www.cashfactory.net/> (last visited Jan. 25, 2001).

111. <http://www.expertfunding.com/> (last visited Feb. 25, 2002).

112. <http://www.hsacfunding.com/> (last visited Feb. 5, 2002).

113. <http://www.lawsuitfinancial.com/> (last visited Feb. 25, 2002).

114. <http://www.nationallawsuitfunding.com/> (last visited Feb. 25, 2002).

vices,¹¹⁵ Resolution Settlement Corp.,¹¹⁶ and RJR Capital Resources.¹¹⁷

Locating in Nevada is probably a good idea for litigation financing firms because Nevada does not have usury laws (Idaho, New Hampshire, Oregon and Wyoming also do not.). If their agreements state that the law of Nevada will apply to the agreements, most courts would probably apply Nevada law and uphold the agreements even if the forum state has usury laws. Courts have held that “usury laws are not so distinctive a part of a forum’s public policy that a court, for public policy reasons, will not look to another jurisdiction’s law which is sufficiently connected with a contract and will uphold the contract.”¹¹⁸ The Florida Supreme Court has noted that Florida’s usury statute has so many exceptions that it cannot indicate the presence of a strong public policy.¹¹⁹ The same is true of the usury statutes in most states. Moreover, it is “a well-established rule that a provision in a contract for the payment of interest will be held valid in most states if it is permitted by the law of the place of contracting, the place of performance, or any other place with which the contract has any substantial connection.”¹²⁰ In 1935 a well-known commentator wrote that:

[T]he rule has become well settled in almost all jurisdictions, too well settled to be changed except by statute, that if a contract is made and to be performed in different states, and is usurious by the law of one of these places but not by that of the other, it is governed, according to the presumed intention of the parties, by the law of the place which makes it valid.¹²¹

Nowadays, courts do not generally focus on presumed intent, but rather on the expectations of the parties because it is common for intentions to be expressed in the agreement.¹²² The Restatement

115. <http://www.plaintiffsupport.com/> (last visited Feb. 25, 2002).

116. <http://www.resolutionsettlement.com/> (last visited Feb. 25, 2002).

117. <http://www.americancashflow.com/rjrcapital> (last visited Feb. 25, 2002).

118. *Continental Mortgage Investors v. Sailboat Key, Inc.*, 395 So. 2d 507, 509 (Fla. 1981); *see also Ury v. Jewelers Acceptance Corp.*, 38 Cal. Rptr. 376 (Dist. Ct. App. 1964); *Santoro v. Osman*, 174 A.2d (800 Conn. 1961); *Big Four Mills v. Commercial Credit Co.*, 211 S.W.2d 831 (Ky. 1948); *Exchange Bank & Trust Co. v. Tamerius*, 265 N.W.2d 847 (Neb. 1978). *But see Lyles v. Union Planters Nat’l Bank*, 393 S.W.2d 867 (Ark. 1965).

119. *Continental Mortgage Investors*, 395 So. 2d at 509.

120. *Id.* at 510 (citing this “traditional” or “federal” rule” derived from *Seeman v. Philadelphia Warehouse Co.*, 274 U.S. 403, 408 (1927)).

121. *Id.* (citing Professor Beale in 2 J. BEALE, *CONFLICT OF LAWS* § 347.4 (1935); *see, e.g., Speare v. Consol. Assets Corp.*, 367 F.2d 208 (2d Cir. 1966); *Cooper v. Cherokee Vill. Dev. Co.*, 364 S.W.2d 158 (Ark. 1963); *Ury*, 38 Cal. Rptr. 376; *Big Four Mills*, 211 S.W.2d 831; *Sievers v. Diversified Mortg. Investors*, 603 P.2d 270 (Nev. 1979); *Goodwin Bros. Leasing, Inc. v. H & B Inc.*, 597 S.W.2d 303 (Tenn. 1980).

122. *Cont’l Mortgage Investors*, 395 So. 2d at 510.

(Second) of Conflict of Laws states: “[T]he courts deem it more important to sustain the validity of a contract, and thus to protect the expectations of the parties, than to apply the usury law of any particular state.”¹²³

It is surprising in the *Rancman* case that FSF apparently did not argue that the laws of Nevada should apply rather than the laws of Ohio. FSF is a Nevada corporation, and the agreement that Rancman signed contained a clause stating that Nevada laws would control the agreement.¹²⁴ Given the law as generally applied in most states, the Ohio appellate court should have deemed enforcing the contract more important than applying Ohio’s usury law or its related Small Loan Act. On the other hand, the court’s emphasis in a brief opinion on the amount of money Rancman had to pay for the cash advance she received, suggests that the court was going to invalidate the agreement in spite of any other factors.

VI. CONCLUSIONS

This article does not make the case that it is necessarily a good thing for plaintiffs without their own financial resources for medical and general living expenses to pay back three times what they were advanced by litigation funding companies. However, it does point out the following: (1) Lawyers in almost all states cannot advance the funds to their clients because such advances violate professional codes of ethics; (2) Traditional lenders will not lend funds to borrowers with nothing as collateral except a pending lawsuit because lenders view such loans as too risky; (3) Plaintiffs without the financial wherewithal to have staying power in cases against wealthy corporate defendants may be forced to give up their suits or to accept settlements for much less than their cases are worth; (4) There are now so many companies in the litigation financing business that they will be forced by the market into more competitive pricing; (5) The clients of litigation funding companies have lawyers to advise them about their borrowing agreements; and (6) Litigation always contains risk – there are no sure things.

It is this last factor that makes a court wrong when it determines that a cash advance to be repaid with additional fees, only if the recipient recovers in a lawsuit, is a loan because there is no contingency by which the funding company will not get paid. It is the first five factors

123. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 203 cmt. b (1971).

124. Plaintiff Agreement between Roberta Rancman and Richard C. Ashcroft for Future Settlement Funding Corp. (Apr. 29, 1999) (on file with the author).

that make such a determination bad policy. The important disparity in interest is not between plaintiffs and litigation funding companies but between plaintiffs and defendants. There can be no justice system when there is a vast financial discrepancy between plaintiffs and defendants. Litigation financing companies, just like lawyers who take cases on a contingency fee basis, help level the playing field. If plaintiffs, after receiving advice of counsel, are satisfied to pay back three times what has been advanced, because that is the only way they can withstand the delaying tactics of defendants and reject low settlement offers, it is bad lawmaking for courts to void such agreements based, ostensibly, on the lack of contingencies but, in reality, on outrage at the cost of the advances.

The implication is not that litigation financing companies should get a windfall for leveling the playing field for indigent plaintiffs. Nevertheless, declaring the advances of funds to be loans subject to usury laws is unrealistic. Holding these companies to the same interest rates as banks, that will not provide the funds at those rates, will result only in eliminating the sole access these plaintiffs have to a fair litigation system. Most states have business and some consumer exceptions to their usury statutes, so this situation is certainly not unique. On the other hand, if these companies are successful and could also be successful charging lower premiums, perhaps banks will decide to compete at their regulated interest rate. One useful area of new regulation might be in requiring full disclosure of the fee, as a percent of the funds advanced, if the litigation is successful. With all the relevant information, the plaintiff could do a better job of comparison-shopping for litigation financing. Plaintiffs seeking these funds are not, however, in as vulnerable a position as many consumers, because, almost by definition, they have legal advice available to them.

The litigation financing idea is a new business worth preserving. If courts persist in throwing obstacles in its way, then state legislatures may need to step in to clarify that neither champerty prohibitions nor usury limitations apply.