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New York's Unregulated Litigation Lending Industry

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By Heather R. Abraham and Maura Graham

Third-party litigation lending is booming, but at whose expense? Litigation loans are advance payments to individuals or companies to finance lawsuits in exchange for a portion of the potential legal recovery. Demand for this lending has substantially increased "with no signs of slowing down," according to Westfleet Advisors, which tracks the industry.[1] Moreover, the industry operates under minimal state or federal regulation.[2]

While the industry primarily finances large-scale commercial litigation, it also targets individual consumers. Would-be plaintiffs are turning to third-party loans to finance everything from personal injury to police misconduct to wrongful conviction lawsuits.[3] As the industry gains traction, so are its most vocal critics, including the U.S. Chamber of Commerce and a miscellany of lawmakers.[4]

This article is a primer on the common concerns raised by litigation lending, the history of litigation lending in New York, how it may affect your practice, how some states regulate it and options for New York.

What Are Litigation Loans?

Litigation loans – also called third-party litigation financing or consumer litigation lending – offer claimants financial support while they await a settlement or other payout. The typical funder is a third party who lends for the potential return on investment. While there is no universal definition, third-party funding agreements typically share five common traits: (1) a cash advance (2) made by a non-party (3) in exchange for a share of the litigation or arbitration proceeds (4) from settlement, judgment or other recovery (5) payable at the time of recovery – if and only if – such recovery occurs.[5] Defendants may also seek litigation loans.

There are two broad categories of litigation lending: consumer and commercial. Each category raises its own ethical concerns. This article highlights some concerns raised by all litigation loans but primarily focuses on the unique hazards of consumer loans.

'Legal Loan-Sharking'

The primary justification for consumer lending is expanding access to justice. Lending increases the chances that would-be plaintiffs initiate and sustain litigation, especially against well-resourced defendants, and helps them secure legal counsel. Even so, litigation loans raise a host of ethical concerns.

Critics voice three central concerns: unconscionable interest rates, interference with attorney-client privilege and the influence of third-party funders over litigation decision-making.

Unconscionable Interest Rates

Consumer litigation loans are commonly criticized for violating usury laws. Usury is "charging financial interest in excess of the principal amount of a loan" or, more broadly, "interest above the legal or socially acceptable rate."[6] Usurious transactions are characterized by three common elements: a loan or forbearance, an absolute obligation to repay the principal (not contingent on any event) and greater compensation for the loan.[7] Some sources cite interest rates ranging from 36%[8] to 124%,[9] whereas the going rates for unsecured personal loans are 6 to 35.99% and credit cards are 28%.

Interference With Attorney-Client Privilege

Litigation lenders may request confidential and privileged information to determine whether to grant a cash advance.[10] In New York City, for example, an attorney can represent a client who has obtained a lawsuit loan, but the attorney must inform the client of the potential ethical complications, including potential waiver of attorney-client privilege and the potential impact on the exercise of independent judgment.[11] Lenders generally do not fall within the scope of attorney-client privilege, meaning the privilege does not protect litigation loan companies' communications with clients and attorneys.[12] Legal scholars have considered how to extend privilege to lenders, but the differences in interests between them and plaintiffs makes this a difficult needle to thread.[13]

Influence of Third-Party Funders

Litigation lenders are not bound to the same ethical rules as attorneys, so there is little stopping funders from interfering like pressuring clients to settle – or not.[14] As such, lenders may impinge on a client's agency in litigation. To illustrate the point, Burford Capital Limited, the "biggest litigation funder in the world," recently made headlines after a commercial litigation loan recipient – Sysco Corp – decried Burford's interference when Burford brought an arbitration proceeding to enjoin Sysco from finalizing settlement in antitrust litigation.[15] As summarized by one news outlet, Sysco argued that "it is a litigation hostage, forced by a greedy funder to keep litigating cases that it wants to resolve."[16] It remains to be seen how courts will resolve such disputes.

Litigation Lending in New York

In 1994, the New York State Bar Association's Committee on Professional Ethics issued an early opinion on litigation lending. While it did not prohibit lawyers from accepting litigation loans, it strongly cautioned attorneys on the potential risks to confidentiality and warned attorneys that clients must provide informed consent for any loan-related disclosure of confidential information.[17] Since then, the bar association has gone on to provide opinions surrounding conflicts of interest and a lawyer's personal interest in a litigation funding agency.[18]

The New York City Bar Association (NYCBA) has also opined on litigation financing. In 2011, it flagged concerns about the potential interference with confidentiality, attorney-client privilege and client independent judgment.[19] In 2018, it addressed the issue of fee-sharing as it relates to litigation funding.[20] That opinion generated substantial interest, which led to the creation of the NYCBA Working Group on Litigation Funding. The working group created four subcommittees: (1) ethical rules, (2) best practices, (3) disclosure and (4) consumer litigation.[21] The working group issued a detailed report with recommendations, including amendments to the New York Rules of Professional Conduct, proposed guidelines and best practices for attorneys, and suggestions to improve the Consumer Litigation Funding Bill.[22] It also advised against mandatory disclosure of a client's use of litigation loans.[23]

Regulatory Approaches

Usury Laws

Jurisdictions vary in how they regulate litigation loans. In most states, usury laws and regulations only apply to traditional loans, not nonrecourse debts[24] – i.e., loans in which the lender can only pursue the collateral. Since litigation loans are typically treated as nonrecourse debt, usury laws are unlikely to limit interest rates. However, a few jurisdictions do have usury laws that regulate nonrecourse loans.[25] Additionally, some jurisdictions treat litigation loans as traditional loans. For instance, the Colorado Supreme Court has held that litigation financing is a "loan" subject to the Colorado Uniform Consumer Credit Code because "the transactions create debt, or an obligation to repay, that grows with the passage of time."[26]

Champerty and Maintenance Laws

Some jurisdictions use champerty and maintenance laws to regulate these loans. Historically, these common law doctrines prohibited the involvement of third parties in lawsuits.[27] Specifically, maintenance prevented a third party from financing another person's litigation, and champerty prevented financing it in exchange for a portion of the damages recovered.[28]

Champerty's ability to regulate litigation loans depends on the state's adherence to the doctrine.[29] Even if these doctrines are invoked, litigation lenders may avoid champerty-enforcing jurisdictions through arbitration clauses that remove the case to a jurisdiction that does not enforce maintenance and champerty.[30] Empirically, some courts have voided litigation lending agreements for violating champerty doctrine,[31] but other courts have rejected these claims.[32]

Currently in New York, champerty is interpreted to regulate third-party involvement when the purpose of taking the claim is "with the intent to sue."[33] Thus, "as long as the primary purpose and intent of the assignment [is] for some other reason than bringing suit," financial investment in litigation is permissible in New York.[34]

Disclosure Requirements

In California, the Predatory Lawsuit Lending Prevention Act, SB 581, as originally introduced, would have required all parties in state court lawsuits to disclose whether outsider investors were funding the case.[35] After substantial opposition, the proposal was amended to require disclosure only when ordered by a judge.[36] The Legislature has not adopted the resolution. In some instances, courts require third-party financing disclosures, such the U.S. District Court for the District of New Jersey, and one federal judge in Delaware requires disclosures in patent cases.[37]

Other jurisdictions have adopted lesser protections, like requirements that the lending agreements be written in clear language.[38] Vermont requires lenders to disclose alternative options to litigation funding, such as personal loans and life insurance policies.[39]

The New York Attorney General's Office has also attempted to regulate the industry. In 2005, it authorized an "Assurance of Discontinuance Pursuant to Executive Law Section 63(15)" agreement with litigation funders, which addresses a variety of concerns raised by the AG's office. While only binding on nine signatories, it nonetheless offers guidelines for the industry as a whole.[40] For instance, the assurance requires litigation funding contracts to comply with the Plain Language Law, and contain certain financial disclosures on the front page.[41] Additionally, consumers must be advised to consult with their lawyer before signing the funding agreement, they must be given five business days to cancel the agreement and the attorney's fees must be reasonable.[42]

Proposed Reforms in New York

Nationwide, a hodgepodge of critics is calling for reform.[43] Some state legislatures have passed consumer-focused statutes[44] but not without significant pushback.[45]

In New York, the Legislature has considered, but not passed, the Consumer Litigation Funding Act, which was first introduced in the 2017–2018 session and has been reintroduced each subsequent session.[46] If passed, it would limit interest rates, restrict fee-sharing, require disclosures, set penalties, define how litigation loans would impact attorney-client privilege and require registration and reporting.

Among its key provisions, the bill would allow consumers to rescind a litigation loan contract within 10 days of signing and would require that the contract be written in clear and coherent language.[47] It would also require that all fees be stated clearly on the disclosure form, that a contract disclose the maximum amount the plaintiff may be required to pay the funding company and a clear payment schedule, and would prohibit companies from charging fees outside the disclosure form. This differs from some states that address the issue of compounding interest and provide a time limit on when the interest may be compounded.[48]

In terms of attorney-client privilege, the bill would expand the privilege to include communication between the lending company and the consumer's attorney. An alternative approach used by some jurisdictions is simply to clarify by statute that communication between attorneys and funding companies does not limit, waive or abrogate the scope of the privilege.[49]

Regarding registration and licensing, most states that have adopted legislation require litigation lenders to register or obtain a license.[50] Some states require lending companies to prove they operate fairly and honestly[51] and may be subject to background checks.[52] The New York bill would require lenders to register with the New York secretary of state and submit to an evaluation of character and fitness that warrants the belief that the business will be operated honestly and fairly.[53] Like other states, it would also require annual reports or data submission regarding the administration of legal funding.[54] It would not, however, require licensing for lending companies.

Finally, for enforcement, some states include a fine or penalty for operating a consumer litigation financing company without a license.[55] If a funder is found to be in willful violation of the statute, many states consider the contract void,[56] and some states reserve the right to revoke the funder's license.[57] Similarly, the New York bill provides that a willful violation could revoke the company's ability to recover from the contract and could result in additional fines.

In its 2018 report, the NYCBA Working Group on Litigation Funding recommended amending the bill to (1) insert a definition of "consumer," (2) include reporting requirements, (3) remove fee caps, (4) revise the penalty provision to include only forfeiture of fees and charges, and (5) restrict the ownership of litigation financing companies by attorneys and judges.[58]

Conclusion

To date, third-party litigation lenders have operated in relative obscurity. As the litigation loan industry grows, New York attorneys should be well aware of the potential ethical concerns for attorneys and their clients and take steps to inform their clients of these risks or avoid them altogether.

Endnotes

1. Westfleet Advisors, 2022 Litigation Finance Market Report 2, www.westfleetadvisors.com/wp-content/uploads/2023/02/WestfleetInsider-2022-Litigation-Finance-Market-Report.pdf.

2. U.S. Gov't Accountability Off., Gao-23-105210, *Third-Party Litigation Financing: Market Characteristics, Data, And Trends 23-26* (2022); New York City Bar Assoc. Comm. on Prof'l Ethics, Formal Op. 2011-2: Third Party Litigation Financing, www.nycbar. org/index.php/ethics/ethics-opinions-local/2011-opinions/1159-formal-opinion2011-02 (litigation loans have garnered "increased attention, both within and outside the legal profession, in part because the arrangements are largely unregulated").

3. *See, e.g.*, Corey Kilgannon, *They Were Unjustly Imprisoned. Now They're Profit Centers*, N.Y. Times, Nov. 27, 2022.

4. *See, e.g.,* U.S. Chamber of Commerce, Statement for the Record for the House Oversight Hearing, *Unsuitable Litigation: Oversight of Third-Party Litigation Funding*, (Sept. 12, 2023).

5. Bernardo M. Cremades Jr., *Usury and Other Def. in U.S. Litig. Fin.*, 23 Kan. J. L. & Pub. Pol'y 151, 152 (2013).

6. *Id.* at 158.

7. *Id.* at 170.

8. Daniel Brook, *Litig. by Loan Shark*, Legal Affairs 42–43 (2004).

9. *See* Consumers for Fair Legal Funding, https://fairlegalfunding.org/ (Last Visited June 1, 2023).

10. *See, e.g.*, Steven Garber, *Alt. Litig. Fin. in the U.S.: Issues, Knowns, and Unknowns*, Rand Law, Finance, and Capital Market, 2010, at 19; Grace M. Giesel, *Alt. Litig. Fin. & the Att'y-Client Privilege*, 92 Denv. Univ. L. Rev. 95 (2014).

11. Thurbert Baker, *Paying to Play: Inside the Ethics and Implications of Third-Party Litig. Funding*, 23 Widener L. J. 229, 235–36 (2013) (discussing New York City Bar Association Formal Opinion 2011-2).

12. Giesel, *supra* note 9, at 105; *see generally In Re Outlaw Lab'y, Lp Litig.*, 2021 WL 5768123 (S.D. Cal. 2021); *Finjan, Inc. v. Sonicwall Inc.*, 2020 WL 4192285 (N.D. Cal. 2020).

13. Giesel, *supra* note 9, at 140; Nevada has expanded the scope of attorney-client privilege to encompass lenders. *See* Nev. Rev. Stat. Ann. § 604c.240 (West 2023) (communication between the funding company and consumer's attorney is "subject to the attorney-client privilege, including . . . the work product doctrine").

14. Lesley Stahl, *Litig. Funding: A Multibillion-Dollar Industry for Inv. in Law With Little Oversight*, CBS News, Dec. 18, 2022, www.Cbsnews.Com/News/Litigation-Funding-60-Minutes-2022-12-18; *see* Maya Steinitz, *Whose Claim Is This Anyway? Third-Party Litig. Funding*, 95 Minn. L. Rev. 1269, 1272 (2011).

15. Alison Frankel, *Sysco Sues Litigation Funder Burford, Blasts Boies Schiller Over $140 Million Soured Deal*, Reuters, Mar. 9, 2023, www.Reuters.Com/Legal/Legalindustry/Sysco-Sues-Litigation-Funder-Burford-Blasts-Boies-Schiller-Over-140-Million-2023-03-09.

16. *Id.*

17. N.Y. Bar Ass'n Comm. on Prof'l Ethics, Op. 666 (1994).

18. N.Y. Bar Ass'n Comm. on Prof'l Ethics, Op. 1145 (2018) (neither the lawyer nor their firm may represent a client in a litigation funded by a company in which the lawyer is an investor); N.Y. Bar Ass'n Comm. on Prof'l Ethics, Op. 1206 (2020) (Firm May Not Refer Its Clients To A Litigation Funder Where The Sole Owner Of The Financing Company Is Married To A Firm Attorney); N.Y. Bar Ass'n Comm. On Prof'l Ethics, Op. 1196 (2020) (lawyer is permitted to refer to a litigation financing agency owned by the attorney's sibling when the parent or legal guardian consents); N.Y. Bar Ass'n Comm. on Prof'l Ethics, Op. 1108 (2016) (lawyers in criminal matters may refer potential clients to litigation financers for the lawyer's legal fees even when the lawyer pays certain fees to the lender in connection with a financing program so long as the lawyer obtains informed consent and the lawyer's payment to lender does not constitute as financial assistance to the client).

19. N.Y. City Bar Assoc. Comm. on Prof'l Ethics, *supra* note 2.

20. N.Y. City Bar Assoc. Comm. on Prof'l Ethics, Formal Op. 2018-5, *Litigation Funders' Contingent Interest In Legal Fees*, https://S3.amazonaws.com/documents.nycbar.

Professor Heather R. Abraham directs the Civil Rights & Transparency Clinic at the State University of New York at Buffalo School of Law, a litigation clinic that offers pro bono client representation in the areas of civil rights and government accountability. Her academic research examines enforcement of federal, state, and local fair housing laws, and explores how fair housing laws can be used to reduce residential segregation.

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org/files/2018416-litigation_funding.pdf (lawyer-lender agreement violates rule 5.4 prohibition on fee sharing when lawyer's payments are contingent on the lawyer's receipt of legal fees).

21. N.Y. City Bar Assoc. Working Group on Litigation Financing, Report to the President (2020), http://documents.nycbar.org/files/report_to_the_president_by_litiga-tion_funding_working_group.pdf.

22. *Id.*

23. *Id.*

24. Cremades, *supra* note 4, at 162.

25. *Id.* at 187; *see also Odell v. Legal Bucks, Llc*, 192 N.C. App. 298, 313–16 (N.C. Ct. App. 2008).

26. *Oasis Legal Fin. Group, LLC v. Coffman*, 361 P.3d 400, 410 (Colo. 2015).

27. Baker, *supra* note 10, at 231.

28. *Id.*

29. Cremades, *supra* note 4, at 189, 190–92 (Georgia, Minnesota, Mississippi, and Maryland are among the states that enforce the doctrines of champerty and maintenance, whereas Oregon and Texas apply the doctrine on a case-by-case basis, and New Jersey and Massachusetts do not enforce the doctrine).

30. *Id.* at 190.

31. *Rancman v. Interim Settlement Funding Corp.*, 789 N.E.2d 217 (Ohio 2003) (violated champerty and maintenance); *Johnson v. Wright*, 682 N.W.2d 671 (Minn. Ct. App. 2004) (violated champerty and public policy because "respondents effectively intermeddled and speculated in appellant's litigation and its outcome"). *But see Maslowksi v. Prospect Funding Partners LLC*, 944 N.W. 2d 235, 238-41 (Minn. 2020) (abolishing the common-law prohibition against champerty but observing that courts "may still scrutinize litigation finance agreements to determine whether equity allows their enforcement," referencing the common-law defense of unconscionability).

32. *See Odell,* 192 N.C. App. at 309 (not champerty and maintenance because the inter-ference was not clearly officious); *see also Fast Trak Inv. Co., Llc v. Sax*, 2018 WL 2183237 (N.D. Cal. 2018) (not champerty because plaintiff did not exert control over the under-lying case).

33. *Echeverria v. Estate of Lindner*, 7 Misc. 3d 1019 (Sup. Ct., Nassau Co. 2005).

34. *Id.* at 4.

35. Emily R. Siegel, *Cal. Law Funding Bill Slashed After Industry Pushback*, Bloomberg Law, Apr. 27, 2022, https://news.bloomberglaw.com/business-and-practice/California-law-suit-funding-bill-slashed-after-industry-pushback.

36. *Id.*; Press Release, *Senator Anna M. Caballero Proposes Stronger Consumer Protections Against Predatory Lawsuit Lending*, Mar. 1, 2023. *Compare* S.B. 581, California State Senate, Reg. Session 2023-2024 (version dated Feb. 15, 2023) with S.B. 581, California State Senate, Reg. Session 2023-2024 (version dated April 17, 2023).

37. Siegel, *supra* note 34; *see* D.N.J L.Civ.R. 7.1.1 (New Jersey Rule requiring disclosure of third-party litigation funding); Kelcee Griffis, *Fed. Cir. Permits Funding Probes in Delaware Patent Cases*, Bloomberg Law, Dec. 8, 2022, https://news.bloomberglaw.com/ip-law/appeals-court-wont-block-financial-disclosures-in-patent-cases.

38. *See* Okla. St. Ann. Tit. 14a, § 3-806 (West 2013); Ohio Rev. Code Ann. § 1349.55 (West 2008); Neb. Rev. Stat. § 25-3303 (West 2010).

39. *See* Vt. Stat. Ann., Tit. 8, § 2253 (West 2023).

40. N.Y. City Bar Assoc. Working Group on Litigation Financing, *supra* note 20; Julia H. Mclaughlin, *Litig. Funding: Charting a Legal & Ethical Course*, 31 Vermont L. Rev. 615, 654 (2007).

41. N.Y. City Bar Assoc. Working Group on Litigation Financing, *supra* note 20.

42. *Id.*

43. *See, e.g., Fausone v. U.S. Claims, Inc.*, 915 So. 2d 626 (Fla. Dist. Ct. App. 2005) (noting that the Legislature "might examine this industry to determine whether Florida's citizens are in need of any statutory protection"); Michael A. Wittman, *Finding Transparency & Equity in Consumer Litig. Funding*, Prize Winning Papers 21 (2022), https://scholarship.law.upenn.edu/prize_papers/21 (calling for statutory reform).

44. *See* Me. Rev. Stat. Ann. Tit. 9-A § 12-101 (West 2023); Neb. Rev. Stat. § 25-3302 (West 2022); Vt. Stat. Ann, Tit. 8, § 2251 (West 2023); Nev. Rev. Stat. Ann. § 604c.010 (West 2023); W. Va. Code Ann. § 46a-6n-1 (West 2023); Tenn. Code Ann. § 47-16-101 (West 2023); Okla. St. Ann. Tit. 14a, § 3-801 (West 2023).

45. Siegel, *supra* note 34.

46. S9105, 2017-2018 Leg. Sess. (NY 2018); S4555, 2019-2020 Leg. Sess. (NY 2020); S705, 2021-2022 Leg. Sess. (NY 2022); S4146, 2023-2024 Leg. Sess. (NY 2023).

47. *See, e.g.*, S4146, 2023-2024 Leg. Sess. (NY 2023).

48. *See* Me. Rev. Stat. Ann. Tit. 9-A § 12-105 (West 2023); Neb. Rev. Stat. § 25-3305 (West 2022).

49. *See, e.g.*, Vt. Stat. Ann, Tit. 8, § 2255 (West 2023); Neb. Rev. Stat. § 25-3306 (West 2022).

50. *See* Me. Rev. Stat. Ann. Tit. 9-A § 12-107 (West 2023); Neb. Rev. Stat. § 25-3307 (West 2022); Nev. Rev. Stat. Ann. § 604c.500 (West 2023); W. Va. Code Ann. § 46a-6n-2 (West 2023); Tenn. Code Ann. § 47-16-103 (West 2023); Vt. Stat. Ann., Tit. 8, § 2252 (West 2023).

51. *See, e.g.*, Neb. Rev. Stat. § 25-3309 (West 2022).

52. *See, e.g.*, Me. Rev. Stat. Ann. Tit. 9-A § 12-106 (West 2023).

53. S4146, 2023-2024 Leg. Sess. (NY 2023).

54. *Id. See, e.g.*, Me. Rev. Stat. Ann. Tit. 9-A § 12-107 (West 2023); Nev. Rev. Stat. Ann. § 604c.640 (West 2023).

55. *See* Nev. Rev. Stat. Ann. § 604c.840 (West 2023); Okla. St. Ann. Tit. 14a, § 3-815 (West 2023).

56. *See* Nev. Rev. Stat. Ann. § 604c.800 (West 2023); W. Va. Code Ann. § 46a-6n-7 (West 2023); Tenn. Code Ann. § 47-16-107 (West 2023).

57. *See* Nev. Rev. Stat. Ann. § 604c.810 (West 2023); Neb. Rev. Stat. § 25-3309 (West 2022) (Reserving The Right To Revoke, Suspend, Or Refuse To Renew A License After Proper Notice And An Opportunity For A Hearing).

58. N.Y. City Bar Assoc. Working Group on Litigation Financing, *supra* note 20.

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