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# CONSUMER LITIGATION FINANCING IN ILLINOIS: SEEKING SECURITY AND LEGITIMIZATION THROUGH REGULATION

*Michael J. Howlett\**

## I. INTRODUCTION

The Consumer Litigation Financing, also known as Consumer Litigation Funding, (“CLF”) industry has been the subject of an increasing number of commentaries and legislative initiatives across the United States. To date, relatively few jurisdictions have directly regulated the industry via statute, largely through industry-backed bills. Additionally, several jurisdictions have regulated the industry through non-statutory means, including judicial rulings, voluntary agreements, and consent decrees. Illinois has previously attempted to regulate the industry on two occasions. After passing legislation out of the State Senate, the bill failed in the House in 2010. Last session, several bills failed to pass the Illinois General Assembly, which would statutorily recognize and regulate the practice of CLF, but the sponsor has indicated plans on pushing for passage in the upcoming 2014 legislative session. The bill, while substantively similar to industry-backed statutory schemes in other jurisdictions, presents some unique provisions which have not been tested yet in other jurisdictions. This article will begin with a brief overview of the industry and the methods of regulation in other jurisdictions. Further, this article will analyze the unique provisions of the Illinois legislation, and the pending bill as a whole, in light of the relevant Illinois case law and the lobbying efforts surrounding the proposed legislation.

Ultimately, the industry’s push for regulation will in effect, if not by purposeful design, achieve legitimization and

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protection for the industry from legal challenges. The currently-stalled legislative proposals would provide this legitimization. However, any of the proposals would also take the important steps toward protecting consumers of legal services through general regulatory oversight, capping interest rates, and allowing for a consumer protection study and a sunset provision to reevaluate the regulations after sufficient information is compiled.

## II. OVERVIEW OF THE INDUSTRY

The Third-Party Litigation Financing industry has three general segments: (1) Corporate Litigation Finance, (2) Direct funding to law firms, and (3) CLF. It is the third of these segments which merits, and thus far has attracted, the most judicial and legislative attention. This is primarily for two, facially apparent, reasons. First, in the other industry segments, the interests at stake are purely pecuniary as opposed to the compensation for damages sought in a personal injury case. Second, the parties seeking the funding in the first two segments are much more sophisticated actors than most personal injury plaintiffs. As a result, much of the newly passed regulation has focused on CLF, leaving the other segments to be regulated by investment and business-to-business lending statutes.

Generally, there is a dearth of hard data concerning the CLF industry and the characteristics of funding arrangements. However, there are a number of sources and facts that help sketch a rough outline of the industry. First and foremost, it bears noting that the \$100 million industry<sup>1</sup> typically advances low dollar amounts to consumers, generally ranging from \$1,750 to \$4,500,<sup>2</sup> or phrased another way, 10% to 20% of the plaintiffs expected award.<sup>3</sup> That being said, several of the cases far exceeded this amount, with at least one consumer receiving an advance of \$177,500.<sup>4</sup> It is also worth noting that the majority of funding is used by consumers to cover rent or mortgages during litigation, with the greatest percentage aimed at preventing

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<sup>1</sup> Binyamin Appelbaum, *Lawsuit Loans Add New Risk for the Injured*, N.Y. TIMES, Jan. 16, 2011.

<sup>2</sup> Steven Garber, *Alternative Litigation Financing in the United States: Issues, Knowns, and Unknowns*, RAND CORPORATION, at 24-25 (2010) *available at* [http://www.rand.org/pubs/occasional\\_papers/OP306.html](http://www.rand.org/pubs/occasional_papers/OP306.html).

<sup>3</sup> Appelbaum, *supra* note 1.

<sup>4</sup> *Lawsuit Fin. v. Curry*, 683 N.W.2d 233, 240 (Mich. Ct. App. 2004).

foreclosures.<sup>5</sup>

While the sums advanced to consumers generally are small, the interest charged on the advance seems to vary widely, depending on the case or funding company. The figure that is most often presented by the industry is 3-5% monthly compounding interest,<sup>6</sup> which can, in itself, be in excess of 60% Annual Percentage Rate (“APR”).<sup>7</sup> However, that figure is exclusive of fees on the advance, and is by no means standard. One company, LawCash, based out of Brooklyn, New York, reported their average APR on a funding agreement was 16-48%.<sup>8</sup> The American Legal Finance Association—a national business association representing the CLF industry—admits that just a few years ago, the typical monthly percentage was 10%.<sup>9</sup>

As would be expected, sources that are not connected to the industry paint a much different picture. A variety of sources have reported APR’s at 100%,<sup>10</sup> 50% of the advanced amount owed in interest after six months,<sup>11</sup> or even up to 280%.<sup>12</sup> Clearly, there are at least a few instances of corporate actors charging far beyond the self-proclaimed industry standard interest rates.

The rationale behind higher rates is the potential risk in such funding arrangements. Nearly without variation, these funding arrangements are non-recourse, meaning the CLF company has no legal recourse to collect either the principal amount or the interest if the consumer is unsuccessful in their suit or awarded an amount less than what is owed.<sup>13</sup> Facially, this is a valid argument. The higher the risk the company takes, the

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<sup>5</sup> Gail Markels, *Third Party Litigation Financing - Public Policy Aspects*, Conference of Western Attorneys General, July 7, 2011.

<sup>6</sup> Garber, *supra* note 2, at 12.

<sup>7</sup> Darren McKinney, *ATRA Opposes “Third-Party Financing of Lawsuits”*, Press Release, June 14, 2010.

<sup>8</sup> Susan Lorde Martin, *The Litigation Financing Industry: The Wild West of Finance Should Be Tamed Not Outlawed*, 10 Fordham J. Corp. & Fin. L. 55, 73 (2004).

<sup>9</sup> American Legal Finance Association, *Legal Finance: Myth v. Fact, and How ALFA is Helping*, AMERICAN LEGAL FINANCE ASSOCIATION (May 1, 2013),

<http://www.americanlegalfin.com/alfa1/LinkClick.aspx?fileticket=rTxg4Ycm3vA%3D&tabid=71&mid=553> [hereinafter “Myth v. Fact”].

<sup>10</sup> Appelbaum, *supra* note 1.

<sup>11</sup> *Id.*

<sup>12</sup> *Lawsuit Fin.*, 683 N.W.2d at 240.

<sup>13</sup> *Oasis Legal Fin. Grp. v. Suthers*, No: 12CA1130, 2013 WL 2299721, at \*2-4 (Colo. App. Ct. May 23, 2013).

greater their interest rate should be, particularly if they have no recourse should the consumer's suit be unsuccessful. However, far from providing funding for each and every interested consumer, the companies have a rigorous internal review, conducted by attorneys employed by CLF companies.<sup>14</sup> The process is so rigorous that CLF companies have roughly a 70% rejection rate for funding requests,<sup>15</sup> with some companies having individual rejection rates of nearly 95%.<sup>16</sup> Further, it is common industry practice for funding companies to require that the consumer be represented on a contingency fee basis,<sup>17</sup> adding another validator in the form of an attorney agreeing to bear the costs of litigation in expectation of an award or settlement.

### III. CRITIQUES OF CONSUMER LITIGATION FINANCE

Just as payday loans and the subprime lending market before it, CLF incurs its fair share of criticism from consumer protection advocates. Unlike payday loans and subprime lending, the industry also attracts criticisms from tort reform advocates. The consumer protection criticism centers on several aspects of the CLF industry: namely unduly high interest rates, transparency issues, and inflated claims of risk.<sup>18</sup> Tort reform advocates criticize the industry for its potential effects on the quality and length of litigation, settlement amounts, and attorney client privilege.<sup>19</sup>

Far and away, the majority of consumer protection critiques of CLF focus on the issue of predatory rates. Just as

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<sup>14</sup> Oasis Legal Finance, *The Approval Factors for Funding Personal Injury Lawsuits*, OASIS LEGAL FINANCE, (May 1, 2013) [https://www.oasislegal.com/legal\\_finance\\_services/lawsuit\\_funding\\_approval\\_factors](https://www.oasislegal.com/legal_finance_services/lawsuit_funding_approval_factors) [hereinafter "Oasis Approval Factors"].

<sup>15</sup> Appelbaum, *supra* note 1.

<sup>16</sup> Lawrence Schaner, *Third-Party Litigation Funding in the United States*, REVISIT DE ARBITRAGEM E MEDIACAO Jan.-Mar., 175, 186 (2012).

<sup>17</sup> American Legal Finance Association, *Frequently Asked Questions*, AMERICAN LEGAL FINANCE ASSOCIATION (May 1, 2013), <http://www.americanlegalfin.com/faq.asp>.

<sup>18</sup> See generally McKinney, *supra* note 7; *Lawsuit Fin.*, 683 N.W.2d at 590.

<sup>19</sup> See generally John Beisner, Jessica Miller & Gary Rubin, *Selling Lawsuits, Buying Trouble: Third Party Litigation Funding in the United States*, U.S. CHAMBER INST. FOR LEGAL REFORM, 5 (Oct. 2009), <http://www.instituteforlegalreform.com/images/stories/documents/pdf/research/thirdparty litigation financing.pdf>.

with payday loans, the CLF industry is being criticized for charging extraordinarily high rates, evidenced by interest charges of up to 280%.<sup>20</sup> Even if the 280% APR is considered to be an outlier, rates of 100% APR have been consistently reported.<sup>21</sup> In fact, the CLF industry itself has admitted to historically charging 10% monthly compounding interest,<sup>22</sup> far above statutorily authorized lending rates for other types of high-risk cash advances.<sup>23</sup> Further, even though it is true that the industry as a whole has lowered the monthly percentages charged to consumers, 2 - 4% monthly compounding interest can often be in excess of 60% APR,<sup>24</sup> in addition to the charges and fees companies typically charge. Even these lower rates are nearly double the statutorily authorized amounts for payday loans,<sup>25</sup> and are certainly higher than credit card and traditional bank lending rates.<sup>26</sup>

In response to claims of predatory lending, the industry's typical response is that these higher rates are justified by the level of risk they assume in lending to consumers who may lose their case, precluding the company from recovering.<sup>27</sup> While this argument is logically sound, the claims of risk may be inflated. Far from funding any risky suit where the plaintiff needs funding to bring their case, CLF companies generally have a rigorous vetting process, with in-house lawyers pouring over the case to determine not only the probability of success, but also a likely award amount.<sup>28</sup>

In light of this vetting process, it is unlikely that many of the funded cases do not yield repayments to the companies. As such, the argument that the high-risk nature of the loans necessitates high interests rates, while not theoretically inaccurate, may not be an accurate representation of the real risks

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<sup>20</sup> Lawsuit Fin., 683 N.W.2d at 240.

<sup>21</sup> Appelbaum, *supra* note 1.; Caitlin Ginely, *States Are Battleground in Drive to Regulate Lawsuit Funding*, THE CENTER FOR PUBLIC INTEGRITY, (May 1, 2013), <http://www.publicintegrity.org/2011/02/02/2160/states-are-battleground-drive-regulate-lawsuit-funding>.

<sup>22</sup> Myth v. Fact, *supra* note 9.

<sup>23</sup> 250 ILL. COMP. STAT. 670/15 (2011); Settlement Agreement and Consent Order: DFR-EU-2008-241, Md. Dept. of Fin. Reg. (Aug. 6, 2009) ["Consent Order"].

<sup>24</sup> McKinney, *supra* note 7.

<sup>25</sup> 205 ILL. COMP. STAT. 670/15 (2012).

<sup>26</sup> Garber, *supra* note 2, at 10.

<sup>27</sup> Martin, *supra* note 8, at 65.

<sup>28</sup> Oasis Approval Factors, *supra* note 14.

faced by the industry.<sup>29</sup> Unlike payday lenders, CLF companies have attorneys vetting consumer's suits, determining both the likelihood and potential amount of an award or settlement.<sup>30</sup> As noted above, this process results in an industry-wide rejection rate of 70% for funding requests,<sup>31</sup> with individual rejection rates of nearly 95%.<sup>32</sup> In fact, LawCash reported losing money on only 4% of its cases in a two year period.<sup>33</sup> By means of comparison, payday lenders have a default rate of 10-20%,<sup>34</sup> far above most CLF companies. This apparent disparity between claims of risk and rates charged has led one commentator to note: "The realistic risk of non-recovery [sic] seems very little in comparison to the interest rate and is therefore unjustifiable in relation to the high cost of loans to the consumer."<sup>35</sup>

Related to the criticism of high rates, opponents of CLF are troubled by transparency issues surrounding the industry. In soliciting potential consumers, the industry generally uses television advertising,<sup>36</sup> often in the same tenor and tone of payday lenders<sup>37</sup> and structured settlement and annuity purchasers.<sup>38</sup> While the commercials tout quick access to much needed cash, conspicuously absent is any information relating to the interest rates, terms of the lending agreements, or length of the agreement.

The selective non-disclosure of terms does not end with advertisements. Former CLF company employees have reported that they were instructed not to mention rates to consumers

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<sup>29</sup> Tanya Taubman, *Access to Justice with Protection: Improving Alternative Litigation Financing with Consumer Protections*, paper submitted to Alternative Litigation Funding: a Roundtable Discussion Among Experts, at 35 (2012).

<sup>30</sup> Appelbaum, *supra* note 1.

<sup>31</sup> *Id.*

<sup>32</sup> Schaner, *supra* note 16, at 186.

<sup>33</sup> Martin, *supra* note 8, at 73.

<sup>34</sup> Megan McArdle, *On Poverty, Interest Rates, and Payday Loans*, THE ATLANTIC, Nov. 18, 2009, available at <http://www.theatlantic.com/business/archive/2009/11/on-poverty-interest-rates-and-payday-loans/30431/>.

<sup>35</sup> Taubman, *supra* note 29, at 35.

<sup>36</sup> Oasis Legal Finance, *Lawsuit Funding TV Commercials*, OASIS LEGAL FINANCE, (May 1, 2013), <https://www.oasislegal.com/resources/commercials>.

<sup>37</sup> Cash Net USA, *It's Done With CashNetUSA*, CASH NET USA (May 1, 2013), <http://www.cashnetusa.com/blog/its-done-with-cashnetusa/>.

<sup>38</sup> J. G. Wentworth, *Commercials*, J. G. WENTWORTH, (May 1, 2013), available at <http://www.jgwentworth.com/about/commercials>.

unless asked directly.<sup>39</sup> In another instance, a consumer was quoted a relatively modest APR of 39%, but was later charged upwards of 76% of the loan amount after the first year.<sup>40</sup> Apparently the practice was so widespread in the state of New York that then-Attorney General Eliot Spritzer entered into an agreement requiring a code of conduct and setting base industry practices for New York CLF companies.<sup>41</sup>

The final consumer protection argument against CLF focuses on the core business model of the industry, specifically that it is a for-profit business with little to no interest in justice.<sup>42</sup> The gist of the argument is that these companies, like any investor, are concerned with rates of return, regardless of any underlying benefits provided or detriments caused to the legal system.<sup>43</sup> Rather than being concerned with providing access to the judicial system for those who could not otherwise seek justice and compensation for injury, the industry is more concerned with profit. Buford Capital's CEO Chris Buford's comments are illustrative of the view that pervades the industry: "We're fundamentally a capital provider. We take a share of the ultimate recovery, having taken the risk of funding the case. Forget this being about the law or litigation - we're providing risk funding for an investment in the same way as in any other sector of the market. If the investment pays off we make a return on the capital we're investing."<sup>44</sup> In light of that frank self-assessment of the industry, it is clear that the argument that the CLF industry is unconcerned with considerations of justice is not unfounded. That being said, being unconcerned with justice is not the same as promoting injustice, and certainly does not preclude the industry from encouraging justice, even if it is not a primary goal.

While the consumer protection arguments against CLF

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<sup>39</sup> Appelbaum, *supra* note 1.

<sup>40</sup> *Id.*

<sup>41</sup> Assurance of Discontinuance Pursuant to Executive Law §63(15) In the Matter of Plaintiff Support Services, Inc.; Pre-Settlement Finance, LLC; QuickCash, Inc.; Magnolia Funding, LLC BridgeFunds Limited; Plaintiff Funding Corporation d/b/a LawCash; Oasis Legal Finance Co., LLC; The Whitehaven Group, LLC; New Amsterdam Capital Partners LLC d/b/a LawMax, N.Y. Att'y Gen. (2005).

<sup>42</sup> Matt Byrne, *World's Largest Dispute Financier' Targets US Litigation Market Uptick*, THE LAWYER (May 1, 2013), available at <http://www.thelawyer.com/worlds-largest-dispute-financier-targets-us-litigation-market-uptick/1006248.article>.

<sup>43</sup> *Id.*

<sup>44</sup> *Id.*



are certainly valid and troubling, most of the criticism in academia and most of the opponents lobbying against the industry in state legislatures are focused on tort reform generally. Instead of opposing the industry because of its impacts on consumers, the critics and opponents focus on the effects to the legal system as a whole, particularly any increase in litigation or awards amounts.

The first and most pervasive tort reform criticism of CLF is the effect on the quality and quantity of litigation.<sup>45</sup> On its face, this is a logical argument: the more money given to consumer initiating actions will increase the overall number of suits and incentivize consumers with frivolous claims to bring suit by removing the risk. The argument of increased quantity of litigation is also straight forward: the basic business model of the industry is to provide money to consumers who have claims that are likely to be victorious to pay for expenses during the course of the litigation. Logically, absent this funding, it is unlikely that the consumer would be able to bring their suit.

While there is insufficient data on the American CLF industry to confirm or deny this claim, Australia has seen a 16.5% increase in litigation following the acceptance of the industry.<sup>46</sup> The largest increases in Australia were in class actions and insolvency suits, which are not generally funded by the CLF industry in the United States, and are prohibited in most statutory schemes regulating the industry.<sup>47</sup> However, it should be noted that this argument is proffered by traditional tort reform advocates, such as the U.S. Chamber of Commerce and the American Tort Reform Association,<sup>48</sup> which represent parties with little interest in injured parties receiving compensation, as they typically are the defendants in suits. This argument is further cast into doubt by the fact that most companies require a consumer to have legal representation on a contingency fee basis

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<sup>45</sup> Garber, *supra* note 2, at 28-31.

<sup>46</sup> Beisner, *supra* note 19.

<sup>47</sup> Jason Lyon, *Revolution in Progress: Third Party Funding of American Litigation*, 58 UCLA L. REV. 571, 591 (2010); 2013 IL H.B. 531 HA 2 (NS), 2013 Illinois House Bill No. 531 House Amendment 2, Illinois Ninety-Eighth General Assembly - First Regular Session; 2013 IL H.B. 2301 HCA 1 (NS), 2013 Illinois House Bill No. 2301 House Committee Amendment 1, Illinois Ninety-Eighth General Assembly - First Regular Session.

<sup>48</sup> Sherman Joyce, *Comments of ATRA Concerning Alternative Litigation Financing*, ABA COMMISSION ON ETHICS 20/20, March 7, 2011.

and to have already filed their suit to obtain funding.<sup>49</sup>

Directly related to the argument that CLF will increase the overall volume of litigation is the argument that an increase in litigation will be caused by frivolous claims being filed as a form of speculation. Again, as with quantity, the quality argument appears to be facially sound: the less risk there is to the party to bring a suit, the more incentivized he will be to bring a long-shot suit that has the potential for a high award but may not be meritorious. While this argument is also typically advanced by the tort reform lobby,<sup>50</sup> it is cast into doubt for much the same reasons as the quantity argument. The high denial rate of 70%<sup>51</sup> coupled with the contingency fee representation requirement<sup>52</sup> suggests that a frivolous claim would likely not make it through a CLF company's internal assessments. Moreover, a frivolous lawsuit, likely to be thrown out and unlikely to settle, would be a poor investment and a bad business strategy for the company.<sup>53</sup>

Aside from impacts on the litigation process itself, the tort reform critics of CLF argue the industry negatively impacts settlements, both in the length of time it takes to settle a case and because it may force a consumer to forego an otherwise reasonable settlement offer on account of their obligation to the CLF company.<sup>54</sup> Both of these arguments stem from the same underlying concern that litigation funding artificially inflates the value of a claim, dis-incentivizing reasonable settlement amounts, and prolonging litigation.<sup>55</sup> This force manifests itself in two ways. First, the funding provided to consumers will likely make the consumer disinclined to take early settlement offers because the funding ameliorates their pressing need to settle early—even if the settlement is fair.<sup>56</sup> Second, and nearly the opposite of the first, as the litigation continues the consumer may be dis-incentivized to settle later in the process because of the mounting

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<sup>49</sup> Oasis Approval Factors *supra* note 14; Garber, *supra* note 2, at 29.

<sup>50</sup> Joyce, *supra* note 48.

<sup>51</sup> Appelbaum, *supra* note 1.

<sup>52</sup> Oasis Approval Factors, *supra* note 14.

<sup>53</sup> Myth v. Fact, *supra* note 9.

<sup>54</sup> Rancman v. Interim Settlement Funding Corp., 99 Ohio St. 3d 121, 124-25 (2003).

<sup>55</sup> Joyce, *supra* note 48.

<sup>56</sup> Mariel Rodak, *It's About Time: A Systems Thinking Analysis of the Litigation Finance Industry and Its Effect on Settlement*, 155 U. PA. L. REV. 503, 522 (2006).

interest and fees arising from the funding.<sup>57</sup>

This later argument is of particular concern, and was the basis for the Ohio Supreme Court decision to ban the practice in 2003,<sup>58</sup> though it was later overturned by the Ohio state legislature.<sup>59</sup> In *Rancman v. Interim Settlement Funding Corp.*, the Ohio Supreme Court held that CLF was prohibited as champertous in Ohio because it impedes the settlement of the underlying case.<sup>60</sup> The funding arrangement in the case effectively barred the consumer from settling for anything less than \$28,000 in order to receive any portion of a settlement.<sup>61</sup> This is before taking into account the consumer's own internal settlement amount. This additional deduction, beyond that of a contingency fee, has the potential to make any reasonable settlement offer effectively too low, and force the consumer to push for trial in the hopes of a greater jury award.<sup>62</sup>

The final argument advanced by tort reform critics of CLF is the industry's effect on attorney client privilege, and to a lesser degree the effect on the work product doctrine. Generally, attorney client privilege protects the right to prevent disclosure of certain information communicated in confidence between an attorney and his or her client.<sup>63</sup> This privilege is generally waived if the confidential information is communicated to a third party.<sup>64</sup> The work product doctrine is an extension of this privilege, which protects documents prepared for litigation or in reasonable anticipation of litigation.<sup>65</sup> As such, the concern regarding CLF is that attorney client privilege will be waived when an attorney or the consumer communicates the particulars of the claim to the company assessing the claim.<sup>66</sup> While an inadvertent waiver of

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<sup>57</sup> Rancman, 99 Ohio St. 3d at 124.

<sup>58</sup> *Id.*

<sup>59</sup> Ohio Rev. Code Ann. § 1349.55 (West).

<sup>60</sup> Rancman, 99 Ohio St. 3d at 124.

<sup>61</sup> *Id.*

<sup>62</sup> Rancman, 99 Ohio St. 3d at 124.

<sup>63</sup> BLACK'S LAW DICTIONARY 1317 (9th ed. 2009) ("client's right to refuse to disclose and to prevent any other person from disclosing confidential communications between client and attorney").

<sup>64</sup> Fed. R. Civ. P. 26.

<sup>65</sup> BLACK'S LAW DICTIONARY 1746 (9th ed. 2009): "Tangible material or its intangible equivalent — in unwritten or oral form — that was either prepared by or for a lawyer or prepared for litigation, either planned or in progress."

<sup>66</sup> Grace Giesel, *Alternative Litigation Finance and the Work-Product Doctrine*, 47 WAKE FOREST L. REV. 1083, 1096 (Winter 2012).

the privilege is certainly a cause for concern, the risk appears to be minimal. Most statutes and proposed bills specifically exempt communications to funding companies from waiving the privilege.<sup>67</sup> Further, the investment interests of the CLF industry would be ill-served if in assessing claims the client is placed in a weaker position waiving the privilege.<sup>68</sup>

In assessing the entirety of the arguments against CLF, all are serious issues with potential harm to consumers and further burden an already expensive and overused court system. Yet, most of the above arguments can be ameliorated either by comprehensive regulation or by taking into account the self-interest of the industry, with the exception of the high interest rates and their corresponding effect on settlements. The effects on settlements cannot be regulated because it rests on the internal motivations of consumers who need compensation for injuries, compensation that will be naturally reduced by their obligation to the funding company. So long as interest rates remain high, the effect on settlements is likely to remain.

#### IV. ARGUMENTS IN FAVOR OF CONSUMER LITIGATION FINANCE

Despite the arguments against CLF, in certain circumstances, the service provides a measurable social utility by allowing underprivileged plaintiffs to bring a claim. Arguments in support of the industry generally center on two points: the benefits provided to underprivileged consumers, allowing them to bring claims when they otherwise could not, and internal control measures and safeguards which protect consumers and limit the potential negative impacts of the industry.<sup>69</sup>

The most compelling argument in support, and the most difficult to rebut, is the social utility the industry provides. Regardless of the business motivations of the industry, the fact remains that their services allow consumers to bring claims for compensation when they would be otherwise unable. The typical

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<sup>67</sup> Ohio Rev. Code Ann. § 1349.55 (West); Neb. Rev. Stat. § 25-3306.

<sup>68</sup> Letter from Juridica Capital Management Ltd. to ABA Comm'n on Ethics 20/20, Comments to Issues Paper Concerning Lawyer's Involvement in Alt. Litig. Fin., at 64, 68 (Feb. 2011), available at [http://www.americanbar.org/content/dam/aba/migrated/2011\\_build/ethics\\_2020/comments\\_on\\_alternative\\_litigation\\_financing\\_issues\\_paper.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/migrated/2011_build/ethics_2020/comments_on_alternative_litigation_financing_issues_paper.authcheckdam.pdf).

<sup>69</sup> Myth v. Fact, *supra* note 9.

phrase used is “keys to the court house for the poor.” Moreover, the supporters of the industry argue that the funding advanced to the consumer is typically a relatively small amount, in the tens of thousands of dollars.<sup>70</sup> Further, these relatively low amounts are typically sought, and used for legitimate and important financial obligations. The single largest use of funds is to prevent foreclosures, with many instances of the funds also being used for basic living necessities such as food, and not for litigation or attorney fees.<sup>71</sup>

The industry is providing an undeniably positive social function, truly granting the proverbial keys to the courthouse. However, the price that accompanies this apparent godsend cannot be overlooked. Since CLF companies charge an amount which can take nearly all of the proceeds, the question must be asked - is the consumer in any better of a position by taking this funding?

The general industry response to that question is “yes.”<sup>72</sup> The industry contends, and logic would suggest, that financial assistance to low income consumers early in litigation will increase their bargaining power, which allows them to withstand low settlement offers.<sup>73</sup> While this is undoubtedly true, it does not account for the arguments of exceedingly high rates and such rates forcing consumers to forego potentially reasonable settlement offers, opting to go to trial in search of a higher award.

Aside from the social utility provided by the industry, the other main argument in support of the industry is aimed at ameliorating the perceived ills of the industry. In response to the aforementioned criticism, the American Legal Financing Association and its members have adopted the Best Practices Code of Conduct.<sup>74</sup> The six point voluntary agreement consists of the following pledges: (1) obtaining a written acknowledgement from the consumer’s attorney; (2) the agreement between the company and the consumer will not constitute ownership of the claim and the company will not direct or interfere with the litigation; (3) companies will not advance money in excess of the

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<sup>70</sup> Martin, *supra* note 8, at 73.

<sup>71</sup> Markels, *supra* note 5; Myth v. Fact, *supra* note 9, at 1.

<sup>72</sup> Markels, *supra* note 5.

<sup>73</sup> *Id.*

<sup>74</sup> American Legal Finance Association, *Industry Best Practices - ALFA's Code of Conduct*, AMERICAN LEGAL FINANCE ASSOCIATION (May 1, 2013), available at <http://www.americanlegalfin.com/IndustryBestPractices.asp> [hereinafter “Industry Best Practices”].

consumer's needs; (4) companies will not intentionally overfund cases; (5) companies will not engage in false advertising or intentionally mislead a client; and (6) companies will not offer to or pay commission or referral fees to attorneys for recommending clients.<sup>75</sup>

Certainly all of these provisions are commendable and have the potential to address the concerns of both consumer and tort reform advocates alike. However, the Code of Conduct is less magnanimous than it may appear at first glance. The Code of Conduct was created immediately after and is heavily based on an agreement between the industry and the Attorney General Spitzer of New York.<sup>76</sup> Following a review of the business practices of several companies in New York, Attorney General Spitzer entered an agreement with the companies, for which each company was charged a \$5,000 fee for "costs".<sup>77</sup> The agreement regulated practices much in the same way as the subsequent code of conduct; yet, the New York agreement went much further in regulating the industry,<sup>78</sup> and shares many of the regulatory provisions in subsequent legislation backed by the industry.<sup>79</sup> Moreover, while the Code of Conduct does amend some of the critics concerns, it is notably silent on permissible interest rates.<sup>80</sup>

An additional argument in support of the industry rests on its internal assessment measures as a control on frivolous litigation. In assessing this argument, the practices of Oasis Legal Finance are illustrative of wider industry practices. Oasis funds cases only after a number of criteria have been satisfied.<sup>81</sup> For instance, Oasis will only fund personal injury cases where there were severe injuries, particularly if they resulted in time off work.<sup>82</sup> Oasis generally does not fund soft tissue injury cases because of the volatility in assessing awards.<sup>83</sup> Additionally, Oasis assesses the defendant in the case, with "strong liability" often being determinative, as well as the defendant's ability to pay

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<sup>75</sup> Industry Best Practices, *supra* note 74.

<sup>76</sup> Assurance of Discontinuance, *supra* note 41.

<sup>77</sup> Assurance of Discontinuance, *supra* note 41; Industry Best Practices, *supra* note 74.

<sup>78</sup> Assurance of Discontinuance, *supra* note 41.

<sup>79</sup> Ohio Rev. Code Ann. §1349.55; (West); Neb. Rev. Stat. § 25-3301-3309; Me. Rev. Stat. tit. 9-A, §12-101-107.

<sup>80</sup> Assurance of Discontinuance, *supra* note 41.

<sup>81</sup> Oasis Approval Factors, *supra* note 14.

<sup>82</sup> *Id.*

<sup>83</sup> *Id.*

damages.<sup>84</sup> As previously noted, Oasis is in line with the industry practice of requiring consumers to be represented on a contingency fee basis, ensuring that another party be equally willing to “assume the risk of winning the case.”<sup>85</sup> Finally, and perhaps most illustrative, Oasis requires a “sufficient margin for investment” before agreeing to fund a case.<sup>86</sup> In addressing the margin of investment, Oasis looks to other liens and expenses that will be paid out of litigation proceeds.<sup>87</sup> Oasis examines these liens because CLF obligations are typically the lowest priority claims on litigation proceeds, as would be the case under several of the prospective Illinois bills that would regulate the industry.<sup>88</sup>

As with the voluntary Code of Conduct, Oasis’s approval factors address the criticism of tort reform advocates. Yet, it also serves to undercut the argument that CLF provides access to underprivileged consumers. It is clear that the overall interest of the company is a return on its investment, and not the actual need of the consumer.

In assessing the totality of the arguments for and against the industry, it is clear that some are more pervasive, and therefore more critical to address in any regulatory scheme. These issues are the high interest rates and the corresponding effects on settlements on the one hand, and the undeniable fact that the funding, despite its profit driven motives, provides a tangible benefit to low income consumers seeking to pursue a legal claim on the other.

## V. CURRENT REGULATORY SCHEMES

To date, several jurisdictions have taken on the task of regulating the industry, with the apparent intent of amplifying the social utility of the CLF industry while accounting for the accompanying social ills. Jurisdictions that have regulated the industry have done so in three distinct ways: (1) judicial oversight, (2) executive agreements and regulation, and (3) statutory regulation of the industry.

Several jurisdictions have held third party financing of litigation to be invalid either under champerty or usury. Champerty is generally defined as “an agreement between a

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<sup>84</sup> *Id.*

<sup>85</sup> *Id.*

<sup>86</sup> *Id.*

<sup>87</sup> *Id.*

<sup>88</sup> *See infra* pp. 123, 130.

stranger to a lawsuit and a litigant, by which the stranger pursues the litigant's claim as consideration for receiving part of any judgment proceeds; the act of maintaining, supporting or promoting another person's lawsuit."<sup>89</sup> In one example previously discussed, the Ohio Supreme Court held that third party finance of litigation was void as champertous.<sup>90</sup> Nevertheless, several years after that case decided, the Ohio state legislature overturned the ruling and passed a regulatory scheme supported by the industry.<sup>91</sup>

Other jurisdictions have had more success in regulating litigation funding agreements by judicial ruling. In Oklahoma, the Tenth Circuit prohibited certain third-party funding agreements as champertous.<sup>92</sup> In *Parks v. American Warrior Inc.*, a party agreed to pay for a third of the cost of litigation in return for 40% of the proceeds.<sup>93</sup> The court found the agreement to be "clearly champertous," because it was "officious intermeddling in a suit which in no way belongs to one, by maintaining or assisting the party, with money or otherwise, to prosecute or defend it."<sup>94</sup>

Perhaps more relevant than third-party funding generally, several jurisdictions have specifically struck down forms of CLF as either usurious or champertous. In an example from Michigan, the state Supreme Court struck down a CLF agreement as usurious.<sup>95</sup> In *Lawsuit Financial, LLC v. Curry*, the court held that non-recourse loans were still loans, regardless of their non-recourse nature.<sup>96</sup> Because the agreements were found to be loans, the agreements were held to be usurious, as interest rates of 280% far exceeded Michigan's maximum lawful annual interest rate of seven percent.<sup>97</sup>

While non-recourse loans are not generally seen as loans by most jurisdictions and therefore not subject to usury laws, a Colorado State Appellate Court ruled in *Oasis Legal Finance et. al. v. Suthers* that such financial agreements are loans for the purposes of regulation.<sup>98</sup> In reviewing an appeal of a granted

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<sup>89</sup> BLACKS LAW DICTIONARY 262 (9th ed. 2009).

<sup>90</sup> See *infra* pp. 113.

<sup>91</sup> Ohio Rev. Code Ann. § 1349.55 (West).

<sup>92</sup> *Parks v. Am. Warrior, Inc.*, 44 F.3d 889, 893 (10th Cir. 1995).

<sup>93</sup> *Parks*, 44 F.3d at 893.

<sup>94</sup> *Id.*

<sup>95</sup> *Lawsuit Fin.*, 683 N.W.2d at 240.

<sup>96</sup> *Id.*

<sup>97</sup> *Id.*

<sup>98</sup> *Oasis Legal Fin. Grp., LLC, v. Suthers* 2013 WL 2299721 at \*1 (Colo.



motion for partial summary judgment de novo, the court affirmed the district court's ruling that a non-recourse provision does not remove a funding agreement from the definition of the term loan under the state Uniform Consumer Credit Code ("UCCC").<sup>99</sup> In affirming the lower court, the appellate court held that debt, including contingent debt, falls under the broad definition previously adopted by the Colorado Supreme Court as aligning with the UCCC's underlying purpose of protecting consumers.<sup>100</sup> The court rejected the litigation finance companies' arguments that the loans were non-recourse, on the grounds that the companies have recourse if the consumers break their contracts - for example, if consumer wins and does not or cannot pay the principle plus interest and fees.<sup>101</sup> As such, while usury was not at issue in the appellate review of the partial summary judgment,<sup>102</sup> it is entirely foreseeable that when the UCCC is applied in full force, the agreements could be found to be usurious.

In another such example, a Minnesota court ruled CLF to be void as champertous,<sup>103</sup> similar to the Ohio Supreme Court opinion in *Rancman*.<sup>104</sup> A Minnesota State Appellate Court ruled in *Johnson v. Wright* that an agreement contingent upon the outcome of litigation would be champertous.<sup>105</sup> While the court held that the agreement at issue was not champertous as it was not contingent upon the outcome of the case, the court did find the agreement champertous in assigning a percentage of the proceeds, and therefore a percentage of the legal claim, to the lender.<sup>106</sup>

While several courts have held that non-recourse funding agreements are not loans for the purpose of regulation, jurisdictions are split on the issue. Some courts have held that the non-recourse nature of these funding agreements renders them beyond the scope of the relevant jurisdiction's usury laws.<sup>107</sup>

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App. May 23, 2013).

<sup>99</sup> *Id.* at \*10-13.

<sup>100</sup> *Id.* at \*10-11.

<sup>101</sup> *Id.* at \*15.

<sup>102</sup> *Id.* at \*17.

<sup>103</sup> *Johnson v. Wright*, 682 N.W. 2d 671, 677 (Minn. App. 2004).

<sup>104</sup> *See infra* pp. 113.

<sup>105</sup> *Johnson*, 682 N.W. 2d at 677.

<sup>106</sup> *Id.*

<sup>107</sup> *See Dopp v. Yari*, 927 F. Supp. 814, 822 (D.N.J. 1996) (stating a litigation funding agreement is not usurious because it was a joint undertaking between the parties involved); *See also Kraft v. Mason*, 668 So. 2d 679, 684 (Fla. Dist. Ct. App. 1996) (holding because the profit or interest was

Though certain jurisdictions have succeeded in generally protecting consumers and the legal system from champertous agreements, judicial oversight on this matter is a crude mechanism. Relying on judicial oversight tends to lead to “all or nothing” regulation. Recognizing this, several jurisdictions have taken a different approach - regulating the industry through the state executive branch.<sup>108</sup> The prime example of this is Maryland, where the Commissioner of Financial Regulation entered into a consent order with Oasis Legal Finance in response to licensing complaints against the company.<sup>109</sup> In response to the complaints, Maryland issued a cease and desist order to end all of Oasis’s litigation financing.<sup>110</sup> In response to the cease and desist order, Oasis denied allegations that the agreements were loans or advances under Maryland law, and therefore subject to the Maryland usury laws. Nevertheless Oasis agreed to cease business conduct until Maryland amends the relevant laws.<sup>111</sup> In addition to having operations ceased in the state, Oasis received a \$105,000 fine.<sup>112</sup>

In another aforementioned example, former New York Attorney General Spitzer entered into an agreement with CLF companies in 2005.<sup>113</sup> In addition to the provisions that led to the adoption of the ALFA Code of Conduct,<sup>114</sup> the agreement added additional provisions specifically aimed at consumer protection.<sup>115</sup> These provisions include: (1) disclosure and itemization of fees and APR; (2) a five day cancellation policy; and (3) a natural language provision for those who do not speak English or Spanish.<sup>116</sup> These provisions generally serve as the basis for legislation in several other jurisdictions.<sup>117</sup>

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contingent, the transaction cannot constitute usury); See also *Anglo-Dutch Petroleum Int’l, LLC v. Haskell*, 193 S.W.3d 87, 94 (Tex. App. 2006). (indicating a litigation funding agreement where the investor’s return on investment is contingent on a company’s recovery cannot be usurious).

<sup>108</sup> Consent Order, *supra* note 23; Assurance of Discontinuance, *supra* note 41.

<sup>109</sup> Consent Order, *supra* note 23.

<sup>110</sup> *Id.*

<sup>111</sup> *Id.*

<sup>112</sup> *Id.*

<sup>113</sup> Assurance of Discontinuance, *supra* note 41.

<sup>114</sup> See *infra* pp. 116.

<sup>115</sup> Assurance of Discontinuance, *supra* note 41.

<sup>116</sup> Assurance of Discontinuance, *supra* note 41.

<sup>117</sup> Ohio Rev. Code Ann. §1349.55; (West); Neb. Rev. Stat. § 25-3301-3309; Me. Rev. Stat. tit. 9-A, §12-101-107.

To date, the CLF industry has backed successful legislation recognizing and regulating the industry in three states, Ohio, Maine, and Nebraska.<sup>118</sup> Generally, the relevant statutes of these three states are substantively the same, with minor differences: (1) disclosure of rates, fees and funding amounts; (2) five day cancellation policies; (3) prohibiting companies from affecting the outcome of the case; (4) mitigating impacts on attorney client privileges; (5) prohibiting commissions and referral fees for lawyers; (6) banning companies from making decisions with regards to the course of litigation; and (7) establishing the priority of liens, with the CLF companies' interest as the lowest priority.<sup>119</sup> Specifically, the statutes capped the number of months during which fees can be charged at either 36<sup>120</sup> or 42.<sup>121</sup> Notably absent in any of the laws is a cap on the interests rates and fees to be charged.<sup>122</sup>

## VI. RELEVANT ILLINOIS STATUTES AND CASE LAW

Illinois has not yet addressed the issue of CLF directly, and the law is currently in a state of flux.<sup>123</sup> The only case dealing with the issue in Illinois was a suit over a choice of venue clause in a funding agreement signed in North Carolina, where the court held that an agreement entered into in North Carolina could not be litigated in Cook County.<sup>124</sup> Nevertheless, a look at Illinois statutes and case law is illustrative in assessing whether CLF could be successfully challenged, absent the proposed regulatory scheme supported by the industry and its allies.

The common law and statutory provision most generally applicable to CLF is maintenance. Maintenance is defined as "assisting in prosecuting or defending a lawsuit to a litigant by someone who has no bona fide interest in the case."<sup>125</sup> Further, Illinois has a statute specifically prohibiting maintenance,<sup>126</sup> as

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<sup>118</sup> *Id.*

<sup>119</sup> *Id.*

<sup>120</sup> Ohio Rev. Code Ann. § 1349.55; (West); Neb. Rev. Stat. § 25-3305.

<sup>121</sup> Me. Rev. Stat. tit. 9-A, § 12-105.

<sup>122</sup> Ohio Rev. Code Ann. §1349.55; Neb. Rev. Stat. § 25-3301-3309; Me. Rev. Stat. tit. 9-A, §12-101-107.

<sup>123</sup> Jennifer Gregory, *Payday Loans for Lawsuits? Champerty in Illinois*, CBA RECORD 60, 61 (Oct. 2008).

<sup>124</sup> Parson v. Oasis Legal Fin., LLC., 715 S.E.2d 240, 242 (N.C. App. Ct. 2011).

<sup>125</sup> BLACK'S LAW DICTIONARY 1039 (9th ed. 2009).

<sup>126</sup> 720 ILL. COMP. STAT. 5/32-12 (2009).

well as barratry, which is essentially the continuing practice of maintenance.<sup>127</sup> The statutory prohibition on maintenance has been interpreted by Illinois courts as the officious intermeddling in a suit by one who has no interest and is not a party by maintaining a party, financially or otherwise, with a view toward promoting litigation.<sup>128</sup> Illinois does allow selfless maintenance when the recipient of the support is either one's family member or a person who is impoverished.<sup>129</sup>

Related to maintenance is the offense of champerty. Further, Illinois courts have interpreted champerty as an agreement to pay for litigation in return for part of the proceeds. In other words, "an essential element necessary to constitute champerty [is] an agreement to divide the proceeds of litigation."<sup>130</sup> While champerty is not specifically recognized by statute in Illinois, it has not been abolished by statute, surviving in common law.<sup>131</sup> It should be noted that while champerty does not apply to contingency fee arrangements in Illinois, direct lending to a client by a lawyer is still prohibited.<sup>132</sup> In fact, only the civil-law jurisdiction of Louisiana,<sup>133</sup> and a minority of other jurisdictions including Alabama, Minnesota, Mississippi, Montana, North Dakota, and Texas permit lawyers to lend to clients under certain circumstances.<sup>134</sup>

The final basis for challenging CLF has been usury laws. Usury is an excessive rate of interest charged above the legal amount to the borrower of money.<sup>135</sup> Illinois has regulated interest rates of similar high risk funding agreements, such as Consumer Installment Loans ("payday loans"), setting the interest rate cap at 36% APR.<sup>136</sup> Therefore, any APR above 36% would

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<sup>127</sup> 720 ILL. COMP. STAT. 5/32-11 (2009).

<sup>128</sup> *Savage v. Seed*, 401 N.E.2d 984, 989 (Ill. App. Ct. 1980).

<sup>129</sup> 720 ILCS 5/32-12 (2009).

<sup>130</sup> *Wyman-Gordon Co. v. Lynch Area Fire Prot. Dist.* 366 N.E. 2d 1055, 1057 (Ill. App. Ct. 1977).

<sup>131</sup> *Milk Dealers Bottle Exch. v. Schaffer*, 224 Ill. App. 411, 415 (1st Dist. 1922).

<sup>132</sup> ILL. STATE BAR ASS'N, Ethics Ops. 295 (1968).

<sup>133</sup> LA ST. BAR ART 16 RPC Rule 1.8.

<sup>134</sup> AM. BAR ASS'N, *ABA/BNA Lawyer's Manual on Professional Conduct*, (Sept. 26, 2013, 2:35 PM), [http://apps.americanbar.org/litigation/litigationnews/top\\_stories/docs/ABA\\_Manual\\_Financial\\_Assistance.pdf](http://apps.americanbar.org/litigation/litigationnews/top_stories/docs/ABA_Manual_Financial_Assistance.pdf).

<sup>135</sup> *Central Life Ins. Co. of Illinois v. Sawiak*, 262 Ill. App. 569, 575 (Ill. App. Ct. 1931).

<sup>136</sup> Consumer Installment Loan Act, 205 Ill. Comp. Stat. Ann. 670/15

be considered usurious under the Consumer Installment Loan Act. While consumers and state officials have had success in challenging or regulating CLF agreements on the basis of usury,<sup>137</sup> it is unlikely that this would be an effective challenge in Illinois. This is because under Illinois law, an agreement for which repayment is based on an uncertain contingency cannot be usurious.<sup>138</sup> Since CLF is contingent upon the consumer receiving an award or settlement, it is highly unlikely that CLF could be successfully challenged on these grounds, as in other such jurisdictions.<sup>139</sup>

The state of the law in Illinois regarding these offenses as applied to third-party litigation funding is by no means settled.<sup>140</sup> The last Illinois Supreme Court case addressing third-party funding of litigation was decided in 1914.<sup>141</sup> In *Reiman v. Morrison*, a party had an agreement whereby he would recover one-half of any interest in stolen property another party received from pending litigation.<sup>142</sup> The Court held that such an agreement was not void as champerty because the party had not agreed to bear any of the direct costs of the litigation.<sup>143</sup> In upholding this agreement, the Court laid out how to successfully challenge an agreement as champertous: to make a case of champerty, “it must be shown that the cost and expenses of a suit. . . are paid or agreed to be paid by one not a party to the suit.”<sup>144</sup>

The last Illinois state appellate court opinion addressing third-party funding of litigation was decided in 1989.<sup>145</sup> In *Puckett v. Empire Stove Co.*, a landlord assigned their claim to a tenant to bring suit against a manufacturer of a defective gas valve, in return for terminating the tenant’s right to contribution from the landlord.<sup>146</sup> The court held that the arrangement was not champertous since the landlord was not a stranger to the suit.<sup>147</sup> While upholding this particular arrangement, the court in *Puckett* noted: “champerty and maintenance have been

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(West 2011).

<sup>137</sup> See *infra* pp. 116-118.

<sup>138</sup> *Aldrich v. Aldrich*, 260 Ill. App. 333, 365-66 (Ill. App. Ct. 1931).

<sup>139</sup> See *supra* pp. 120-22.

<sup>140</sup> Gregory, *supra* at note 122.

<sup>141</sup> See generally *Rieman v. Morrison*, 264 Ill. 279 (1914).

<sup>142</sup> *Id.* at 281.

<sup>143</sup> *Id.* at 282.

<sup>144</sup> *Id.* at 286.

<sup>145</sup> *Puckett v. Empire Stove Co.*, 539 N.E.2d 420183 (Ill. App. Ct. 1989).

<sup>146</sup> *Id.* at 427.

<sup>147</sup> *Id.*

disapproved by the courts as public policy because a litigious person could harass and annoy other.”<sup>148</sup>

Finally, the Illinois State Bar Association has previously issued an opinion on the topic of third-party financing, stating that it is not unethical for an attorney to assist a client in obtaining loans related to litigation.<sup>149</sup> However, the opinion was narrowly tailored to situations where the loan was used to pay attorney fees, not where lump sums of money were given to clients to cover basic expenses.<sup>150</sup>

In light of the state of the law in Illinois, and the successful challenges to the funding in other jurisdictions, it is foreseeable that a consumer could successfully challenge a funding agreement in an Illinois court. This uncertainty is troubling to the industry, and is presumably the driving purpose behind their push for regulation. Generally, CLF companies are averse to having their funding arrangements go to trial, and they prefer settlements.<sup>151</sup> For instance, the head of a Brooklyn-based CLF company was quoted as saying, “[e]verything that might have to go before a judge, you stay away . . . we don’t want judges to shine a light on us.”<sup>152</sup> This animosity to judicial review seems to be predicated on the idea that judges perceive a “smell of predatory lending” on the industry.<sup>153</sup> Clearly, the judicial challenges to agreements in various jurisdictions have incentivized the industry to fund cases expected to settle before trial.

Yet, even if the industry is successful in keeping their agreements out of the glare of judicial review, there is still the risk of state executive officers challenging and regulating the industry, as occurred in Maryland and New York.<sup>154</sup> The reality is that if a consumer is successful at trial, his award will be likely greater than any amount for which he could settle. After finding success in Nebraska, Maine and especially Ohio by successfully preempting or even overturning legal challenges to funding, the stage is set in Illinois for a successful industry push for CLF

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<sup>148</sup> *Id.*

<sup>149</sup> ILL. STATE BAR ASS’N, *ISBA Advisory Opinion on Professional Conduct*, (Sept. 26, 2013, 4:13 pm), <http://www.isba.org/sites/default/files/ethicsopinions/92-09.pdf>.

<sup>150</sup> Gregory, *supra* note 122.

<sup>151</sup> Appelbaum, *supra* note 1.

<sup>152</sup> *Id.*

<sup>153</sup> Martin, *supra* note 8, at 63.

<sup>154</sup> Assurance of Discontinuance, *supra* note 41; Consent Order, *supra* note 23.

friendly regulation.

## VII. PENDING ILLINOIS LEGISLATION

Turning to the previous attempts at statutory recognition of CLF in Illinois, the failed 2010 attempt, Senate Bill 3322,<sup>155</sup> (“SB 3322”) was substantively similar to the bills passed in other jurisdictions.<sup>156</sup> Additionally, the most recent attempt to regulate the industry in Illinois, House Bill 2301 (“HB 2301”) as introduced, was roughly the same proposal as offered in SB 3322.<sup>157</sup> HB 2301 would have created the Non-Recourse Civil Litigation Funding Act.<sup>158</sup>

Unlike other jurisdictions, the opponents of CLF, and particularly the Illinois Chamber of Commerce and the Institute for Legal Reform, offered a competing proposal.<sup>159</sup> House Bill 2300 (“HB 2300”) would have regulated CLF as the state regulates other cash advance arrangements, such as payday loans, under the Consumer Installment Loan Act.<sup>160</sup> Notably, this would cap the interest rate of CLF agreements at 36% APR.<sup>161</sup> Additionally, the bill would require disclosure of the agreement to both the court and the defendant.<sup>162</sup>

HB 2300 and HB 2301, as introduced, quickly lost support, in favor of a succession of compromise amendments to HB 2301. House Committee Amendment 1 to HB 2301 (“HCA 1”) added additional provisions to those in the previous legislation and HB 2301: (1) a natural language contract requirement for non-English speakers; (2) a prohibition on funding for class action suits; (3) a prohibition on attorneys and law firms having a financial interest in CLF companies who provide funding for their clients; (4) a cap on payments to only proceeds from the pending litigation; (5) a requirement for companies to only receive an assignment of a contingent right to receive proceeds from a

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<sup>155</sup> S.B. 3322, 96th Gen. Assem., 1st Reg. Sess. (Ill. 2009).

<sup>156</sup> *See supra* pp. 17.

<sup>157</sup> H.B. 2301, 98th Gen. Assem., 1st Reg. Sess. (Ill. 2013).

<sup>158</sup> *Id.*

<sup>159</sup> Bethany Krajelis, *Thapedi Introduces Legislation on Hourly Billing Rates, Lawsuit Lending*, ILLINOIS CHAMBER OF COMMERCE (May 1, 2013), <http://ilchamber.org/news/8617/thapedi-introduces-legislation-on-hourly-billing-rates-lawsuit-lending/>.

<sup>160</sup> H.B. 2300, 98th Gen. Assem., 1st Reg. Sess. (Ill. 2013).

<sup>161</sup> Consumer Installment Loan Act, 205 Ill. Comp. Stat. Ann. 670/15 (West 2011).

<sup>162</sup> H.B. 2300, *supra* note 160.

claim, and not an assignment of the claim itself, which is not to be determined as a percentage of the proceeds; (6) an allowance for companies to fund a consumer who has previously been funded by another company without purchasing the assignment of the first company; (7) caps of specific charges to the consumer; codification of the claim priority of the company; and (8) caps on the fee assessment at 36 months.<sup>163</sup>

While many of these provisions were instituted in various other jurisdictions, Illinois also proposed a provision that is wholly unique. HCA 1 proposed a dual lending provision, providing that consumers seeking litigation funding would have the option of entering into a non-recourse funding agreement or a traditional loan regulated under the Consumer Installment Loan Act (“CILA”).<sup>164</sup> If the CILA option was taken, the APR would be capped at 36%, as it is for other CILA loans, such as payday loans.<sup>165</sup> If the non-recourse funding option were taken, the interest rate would be capped at 36% APR with an additional monthly 3% deferment fee.<sup>166</sup> Further, it should be noted that the CILA option would be regulated under CILA, and not generally under the Act.<sup>167</sup>

HB 2301 was subsequently amended by House Committee Amendment 2 (“HCA 2”), adding: (1) additional disclosure sections; (2) CLF is assignable and not to be construed as a loan or investment for the purpose of regulation; (3) licensure requirements; (4) a data reporting plan to compile a consumer protection study; and (5) a sunset provision repealing the bill for re-passage following the culmination of the consumer protection study.<sup>168</sup> The data collected by this provision would include the number of transactions, the amount of funding in each transaction, the number of transactions required to be repaid, the average annual fee rate, and the total number of transactions where the company received full repayment, partial repayment and no repayment.<sup>169</sup> HCA 2 also contains a superiority clause, meaning that in the event of a conflict between the legislation and

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<sup>163</sup> H.B. 2301, Comm. Amend. 1, 98th Gen. Assem., 1st Reg. Sess. (Ill. 2013).

<sup>164</sup> *Id.*

<sup>165</sup> *Id.*

<sup>166</sup> *Id.*

<sup>167</sup> *Id.*

<sup>168</sup> H.B. 2301, Comm. Amend. 2, 98th Gen. Assem., 1st Reg. Sess. (Ill. 2013).

<sup>169</sup> H.B. 2301, Comm. Amend. 2 *supra* note 168.



other state laws, this legislation supersedes those other laws.<sup>170</sup> While Oasis continued its support of this proposal and the Illinois Chamber continued its opposition, the Illinois Trial Lawyers Association reserved judgment on HCA 2. Perhaps because of this, HCA 2 to HB 2301 failed to pass out of committee before the relevant House deadline, and was re-referred to the Rules Committee pursuant to House Rule 19.<sup>171</sup>

That was not the end of the push for regulation during the 98th General Assembly. State Representative Andre Thapedi (D - 32nd) the sponsor of the previous bills, amended HB 531, a shell bill which had been passed out of committee earlier in the session and was on 2nd Reading in the House, with a regulatory scheme similar to HCA 2. House Amendment 1 (“HA 1”) made several changes to HB 531. While HA 1 to HB 531 preserved the choice-of-loan provision, it changed the percentages for non-recourse loans from 36% with a 3% monthly deferment fee to 36% with a 1.5% bimonthly deferment fee.<sup>172</sup> HA 1 to HB 531 also changed the required disclosures to the consumer, requiring the disclosure of the total dollar amount owed to the company at 30 day intervals for 1080 days, after which no fees could be assessed.<sup>173</sup> Additionally, the amendment added that notwithstanding notice of the non-recourse funding agreement, the consumer’s attorney is not responsible for paying or ensuring payment of the obligation.<sup>174</sup> As with HCA 2 to HB 2301, the Illinois Trial Lawyer Association did not officially support HA 1 to HB 531.

An additional amendment was also filed for HB 531. HA 2 to HB 531 offered several changes to HA 1, specifically: (1) excluding entities that engage in commercial to commercial business transactions from regulation under the act; (2) requiring disclosures of the total dollar amount owed at 180 day intervals, as opposed to 30 days under HA 1, for 1,080 days; (3) shortening the cancelation window from 10 days to 7 days; (4) deleting the provision added in HA 1 that notwithstanding notice of the non-recourse funding agreement, the consumer’s attorney is not responsible for paying or ensuring payment of the obligation; (5) deleting the provision prohibiting funding of class action suits; and (6) adding that nothing in the act shall cause non-recourse

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<sup>170</sup> *Id.*

<sup>171</sup> Rules of the Illinois House of Representatives, Ill. House R. 19(a).

<sup>172</sup> H.B. 531, Comm. Amend. 1, 98th Gen. Assem., 1st Reg. Sess. (Ill. 2013).

<sup>173</sup> *Id.*

<sup>174</sup> H.B. 531, Comm. Amend. 1, *supra* note 172.

lending to be deemed a loan or investment and such agreements cannot be regulated as such.<sup>175</sup>

Additionally, like HA 1, HA 2 to HB 531 preserves the choice-of-loan provision, but changes the interest rate caps for non-recourse funding arrangements back to 36% with a 3% monthly deferment fee from the 1.5% bi-monthly fee in HA 1.<sup>176</sup> Finally, HA 2 would delay the sunset provision and date of consumer protection study from May 31, 2015 to May 31, 2019.<sup>177</sup> Neither HA 1 nor HA 2 contained the superiority clause contained in HCA 2 to HB 2301.<sup>178</sup> HA 2 to HB 531 was supported by the traditional supporters of the industry including Oasis and several other CLF companies, the Illinois Trial Lawyers Association, and the American Legal Finance Association. The opponents to the industry were also largely the same, but were joined by the Illinois Department of Financial and Professional Regulation, the department tasked with regulating the industry under the various bills and amendments.

Despite the rush of amendments to HB 531, it failed to meet the 3rd Reading deadline and was re-referred to the Rules Committee pursuant to House Rule 19.<sup>179</sup> As it stands now, HCA 2 to HB 2301 and both HA 1 and 2 for HB 531 are effectively stalled for the duration of this legislative session, but will be pending in the Rules Committee in January 2014, following the veto session. Rep. Thapedi, after accommodating the various stakeholders in HA 1 to HB 531, still did not expect any of the stakeholders to fully support HA 1.<sup>180</sup> Thapedi recognized that many of the stakeholders will “equally work against the bill because they are not getting everything that they want.”<sup>181</sup> Nevertheless, the Thapedi thinks “the bill that’s filed is soup, and . . . it’s ready to go.”<sup>182</sup> As such, it is entirely foreseeable that Rep. Thapedi will continue his press for statutory recognition and regulation of the industry.

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<sup>175</sup> H.B. 2301, Comm. Amend. 1, *supra* note 163.

<sup>176</sup> *Id.*

<sup>177</sup> *Id.*

<sup>178</sup> H.B. 531, Comm. Amend. 1, *supra* note 172.

<sup>179</sup> Rules of the Illinois House of Representatives, Ill. House R. 19(a).

<sup>180</sup> Andrew Maloney, *Lawsuit Loans Face Regulation in Illinois General Assembly*, CHICAGO DAILY LAW BULLETIN, Apr. 16, 2013.

<sup>181</sup> *Id.*

<sup>182</sup> *Id.*

### VIII. ANALYSIS OF THE BILLS

In assessing the competing provisions offered during the legislative session, it is worth noting the various pieces of legislation were largely industry bills. Oasis has been the strongest and most vocal supporter of the House proposals, supported in their efforts by the American Legal Finance Association. This is further evidenced by the overwhelming similarity between the initially proposed HB 2301 and legislation passed in other jurisdictions. Obviously, there are certain provisions contained in the various proposals that are not part of the industry's ideal bill. Nonetheless, the substance of the bill will still accomplish the goal of legitimizing the industry through statutory recognition. That the industry wants to ensure the practice remains legal in Illinois should go without saying; Cook County is one of the largest unified court systems in the world.<sup>183</sup> The industry would certainly be willing to go to great lengths to ensure its continued operation in such a large market.

Perhaps most notable about the lobbying efforts behind the bill was the shifting stance of the Illinois Trial Lawyers' Association ("ITLA"). Traditionally a strong voice in the state capitol, ITLA supported several versions of the legislation but not all. The combined weight of their lobbying strength when added to that of the CLF industry could prove to be the decisive factor in passing a regulatory scheme in 2014.

It is also worth noting that the opponents of the bill are generally the tort reform advocates that have opposed the industry's lobbying efforts elsewhere. The Illinois Chamber of Commerce and the Institute for Legal Reform, a wing of the U.S. Chamber of Commerce, were the lead opponents of the measures in Illinois. While their opposition may be tangentially related to consumer protection, the Chambers' main interest is in limiting litigation since its members are often the defendants, mimicking the U.S. Chamber's opposition.<sup>184</sup> As such, this seems to be a compromise bill in a true sense of the term, in that the tort reform advocates achieved victories with the inclusion of the sunset provision, ban on referral fees, and interest rate caps on an other-

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<http://www.cookcountycourt.org/ABOUTTHECOURT/OfficeoftheChiefJudge.aspx> (Last visited Sept. 28, 2013).

<sup>184</sup> See *infra* p. 111.

wise industry supported bill.<sup>185</sup>

To the substance of the bills, as stated above, any of the pending amendments, if passed, would accomplish the industry's goal of statutory recognition and regulation of the industry. This seems to be of the utmost importance to the industry, as it would circumvent the harsh judicial review process imposed by other jurisdictions.<sup>186</sup> As previously noted, members of the industry see judicial oversight as the worst possible form of scrutiny and regulation to which the industry could be subjected.<sup>187</sup> There is no greater example of this process than Ohio, where the industry engaged in an extensive lobbying effort to overturn the State Supreme Court's decision to strike down all CLF arrangements.<sup>188</sup>

The industry's fear of judicial review and oversight striking down funding arrangements would likely be completely amended should the pending legislation be passed. Taking champerty first, it is almost certain that any claim would be unsuccessful should any of the pending proposals be passed. Since champerty only survives at common law in Illinois,<sup>189</sup> any legislative enactment would supersede the claim, unless the legislation were struck down as unconstitutional.

The impact on usury challenges would be much the same. Aside from the fact that usury has been found not to apply to non-recourse loans in Illinois,<sup>190</sup> even the CILA loans authorized under provisions would not be seen as usurious since any loan would be capped at 36% APR.<sup>191</sup> Any funding agreement charging less than that rate would not be usurious by definition.

It is unclear how statutory prohibition on maintenance would be interpreted in light of the pending proposals. The picture is most clear for HCA 2 to HB 2301, which includes a superiority clause.<sup>192</sup> This clause, were it to be enacted, would effectively protect the industry from any challenge based on

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<sup>185</sup> Non-recourse Civil Litigation Advances, Ohio Rev. Code Ann. §1349.55 (West 2013); Nonrecourse Civil Litigation Act, Neb. Rev. Stat. § 25-3304 (West 2012); Maine Consumer Credit Code, Me. Rev. Stat. Tit. 9-A, §12-105 (2013).

<sup>186</sup> See *infra* pp. 119-22.

<sup>187</sup> See *infra* pp. 128.

<sup>188</sup> See *infra* pp. 111.

<sup>189</sup> See *infra* pp. 125-26.

<sup>190</sup> Aldrich, 260 Ill. App. at 365-66.

<sup>191</sup> H.R. 531, Comm. Amend. 1, *supra* note 172.

<sup>192</sup> H.R. 2301, Comm. Amend. 2, *supra* note 168.

maintenance. It is unclear, though unlikely, whether a challenge based on maintenance would be successful should either HA 1 or HA 2 to HB 531 pass since they lack a superiority clause.<sup>193</sup>

In comparing the unique provisions of the Illinois proposals to regulatory schemes in other jurisdictions, the provision that is the furthest departure from other jurisdictions is the choice-of-loan mechanism. No other jurisdiction that has regulated CLF has authorized a recourse loan agreement.<sup>194</sup> In theory, this is fundamentally divergent from other schemes. In practice, it is likely that this will operate as if the consumer sought a payday loan instead of litigation financing to support themselves during the initial stages of litigation. While the relative evils of payday loans may be argued, it remains that such cash advances are legal and regulated in Illinois.<sup>195</sup> Moreover, it is likely that this provision was included to allow currently operating CLF companies to continue operations during the three month period allowed for the Illinois Department of Financial and Professional Regulation to go through the rule-making and licensure process.

The Illinois proposals also differ from other statutory regulations of the industry by prospectively implementing a cap on interest rates. Alternatively capped at 36% with a 3% monthly deferment fee<sup>196</sup> and 36% with a 1.5% bi-monthly deferment fee,<sup>197</sup> the bills, if passed, would cap the allowable interest rates at roughly 72% APR plus the deferment fees. While this is certainly high, much higher than most loans, it is worth noting that this would be a ceiling. The loan would still not have to be paid back if the consumer's claim was unsuccessful, and competition would likely drive the interest rates lower in most instances. This is certainly extraordinarily high at first blush, and, in light of the choice-of-loan provision, may drive consumers to opt for the traditional CILA loan, with little consideration of the recourse nature of such a funding agreement.

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<sup>193</sup> H.R. 531, Comm. Amend. 1, *supra* note 172.

<sup>194</sup> Non-recourse Civil Litigation Advances, Ohio Rev. Code Ann. §1349.55 (West 2013); Nonrecourse Civil Litigation Act, Neb. Rev. Stat. § 25-3304 (West 2012); Maine Consumer Credit Code, Me. Rev. Stat. Tit. 9-A, §12-105 (2013).

<sup>195</sup> Consumer Installment Loan Act, 205 Ill. Comp. Stat. Ann. 670/15 (West 2011).

<sup>196</sup> H.B. 531, Comm. Amend. 1, *supra* note 172.

<sup>197</sup> H.B. 531, Comm. Amend. 2, 98th Gen. Assem., 1st Reg. Sess. (Ill. 2013).

While the choice-of-loan and rate cap provisions are important steps and are sure to meet resistance from both proponents and opponents of the industry, the most important provisions in the bill are the data reporting, consumer protection study, and sunset provision. The single biggest hurdle in assessing and regulating the industry to date has been the lack of data regarding the particulars of the industry. On each side of the debate parties generally rely on anecdotal evidence. While it is true that many of the companies use hard data to support their arguments, it is generally limited and unverifiable, as it comes from internal records. Regardless of which bill ultimately passes, by requiring all CLF companies to report hard data on their funding agreements, the consumer protection study that would be submitted to the General Assembly on the eve of the sunset provision will provide vital data necessary in evaluating the effectiveness of the regulatory program.

The previously unregulated nature of this industry means that it is highly unlikely that any regulatory package will be perfect. The sunset provision allows the critics of the legislation an opportunity to seek further regulation in two to five years, depending on which amendment is ultimately adopted and passed. Further, it gives the industry an opportunity to prove its merits, and achieve the legitimization it is seeking.

## IX. CONCLUSION

CLF is a hotly contested issue in law review articles, and in court rooms and state legislatures across the country. It is in the latter that the proponents and opponents have debated the issue in Illinois. After a half dozen proposals, and several parliamentary maneuvers, the issue has stalled for the 2013 legislative session, waiting in committee for the 2014 legislative session.

Merely because the industry is supporting such regulation does not mean that the regulations are per se weak or inadequate. A cursory glance shows that the regulations proposed will serve a workable canvas for additional provisions to be added, either during the legislation process or on the re-passage of the legislation following the sunset provision. Even without accounting for amending the proposal, the provisions common to the various proposals - interest rate caps, bans on referral fees, natural language provision, cancellation policy, disclosure of terms and fees, and priority of claims - all address vital concerns

of both the tort reform lobby and consumer protection advocates.

The choice-of-loan provision will certainly cause some regulatory issues and the interest rate caps on the non-recourse loans have a high sticker price, making the recourse loan an attractive option. But such issues will arise when attempting to regulate any industry which was pervasively unregulated. That is why the most important provision in the any of the pending bills will likely be the consumer protection study and sunset provision.

CLF certainly has it is unsavory aspects, but it does serve a social good, and the pending legislation is a good starting point, contingent of course upon the results of the proposed consumer protection study.