THIRD-PARTY LITIGATION FUNDING: A FRAMEWORK FOR SEPARATING IMPROVED ACCESS TO THE COURTS FROM PRETEXTS FOR USURIOUS LOANS

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Access to justice is sometimes said to be an "expensive luxury."[1] The amount of capital available to fund litigation is correlated to its outcome because increasing the effort exerted on a legal matter, generally, increases both the costs and the chances of winning the case.[2] For a plaintiff who lacks liquidity but has an objectively viable civil case, the ability to extract value from their case before the conclusion of litigation is critical in determining whether they can afford to bring or maintain their claim.[3] The most common solution to the plaintiff's liquidity problem in the United States is contingency fee arrangements between clients and attorneys. Such arrangements occur in 96% of tort cases brought by individuals.[4]

However, contingency fee arrangements between clients and law firms are not always practical. In some cases, the law firm cannot wait for the resolution of the case to be compensated or is uninterested in taking on the risk.[5] While litigation outcomes are often uncertain, such uncertainty also exists with other types of assets. Specifically, this uncertainty exists where financiers use systematic methodologies to assign a present value to the asset that adjusts for its level of risk.[6] Establishing the present value of a litigated claim allows its proceeds to be sold, or for the plaintiff to use the claim as collateral to obtain funding.[7] The general premise of Third-Party Litigation Finance (TPLF) is that the financer provides funding to a plaintiff bringing litigation, in exchange for proceeds of their eventual recovery from the lawsuit.[8] In some cases, this means the financer pays the law firm's hourly rate,[9] while in other cases the financer pays the plaintiff directly.[10]

Regulation of TPLF is lacking, with a countrywide survey of TPLF regulation revealing what is best described as "a patchwork quilt."[11] Because there are no regulations requiring TPLF money to be used for

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1. Max Radin, *Maintenance by Champerty*, 24 CAL. L. REV 48, 71 (1935).

2. Sandro Claudio Lera et. al., *Litigation Finance at Trial: Model and Data*, SSRN, Apr. 23, 2022, at 1, 8.

3. *See* Lesley Stahl, *Litigation Funding: A Multibillion- Dollar Industry for Investment in Lawsuits with Little Oversight*, CBS NEWS (Dec. 18, 2022), https://www.cbsnews.com/news/litigation-funding-60-minutes-2022-12-18/.

4. Lera, *supra* note 2, at 16.

5. David Lat, *An Inside Look at Litigation Finance: An Interview with Chris Bogart,* ORIGINAL JURISDICTION PODCAST (July 31, 2023), https://davidlat.substack.com/p/an-inside-look-at-litigation-finance#details.

6. Aswath Damodaran, *Risk and Return Models in Valuation*, NYU STERN, Ch.5 at 1, 14 (2007), https://pages.stern.nyu.edu/~adamodar/pdfiles/valrisk/ch5.pdf#.

7. Keith N. Hylton, *Economics of Third-Party Financed Litigation*, 8 J.L ECON. & POLICY 701, 708 (2012).

8. *See* Stahl, *supra* note 3.

9. *See* Lat, *supra* note 5.

10. *See Maslowski v. Prospect Funding Partners LLC*, 978 N.W.2d 447, 452-53 (Minn. Ct. App. 2022).

11. *See* Hylton, *supra* note 7, at 702.

its original intended purpose of prosecuting a lawsuit, some financers have used TPLF to do an end-run around usury laws.[12] Specifically, this end-run occurs when a borrower needs a loan and coincidentally happens to have a pending tort case.[13] As this paper will outline, there are two very different ways that TPLF is utilized. Regulation of TPLF should consider the differences between these categories to maximize access to the courts while protecting the public from predatory lending practices that usury laws were designed to prohibit.

I. TPLF TO DIRECTLY FINANCE LITIGATION

In 2022, the largest verdict in the Northeastern United States was just over $2 billion.[14] In 2023, that number ballooned to over $16 billion.[15] This result would not have been possible but for Burford Capital, a firm led by "lawyer/investment banker/CEO" Christopher Bogart.[16] In a recent podcast, Bogart explained that the company was born out of a need to facilitate a deal for a former colleague looking to take on a new case at an AmLaw 100 firm.[17] The client lacked the liquidity to pay hourly rates up-front and was looking for a contingency fee arrangement.[18] However, the firm was not interested in altering its billable-hour structure and replacing it with a contingency fee.[19] Bogart reached an agreement with the client and the firm where Bogart paid the firm's hourly fees in exchange for the client granting Bogart rights to a portion of their recovery from the litigation.[20] This arrangement

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12. *See Maslowski v. Prospect Funding Partners LLC*, 944 N.W.2d 235, 236 (Minn. 2020) (explaining that the money received "was essentially a cash advance on her prospective settlement").

13. *See Echeverria v. Est. of Lindner*, No. 018666/2002, 2005 WL 1083704, at *8 (N.Y. Sup. Ct. Mar. 2, 2005) (holding that plaintiff was so certain to recover in his strict liability personal injury case that there was no meaningful risk taken by the financer, and that the state usury laws would therefore apply).

14. *Northeast's Highest Ranking Verdicts & Settlements Reported by Verdictsearch*, ALMLAW.COM (2022) https://images.law.com/media/thelegalintelligencer/supplements/TVS_NE_2022/index.html#p=1.

15. Jonathan Stempel, *US Judge Says Argentina Owes About $16 Billion After YPF Payout Trial*, REUTERS (Sept. 8, 2023), https://www.reuters.com/legal/us-judge-rules-against-argentina-following-ypf-payout-trial-2023-09-08/.

16. *See* Lat, *supra* note 5.

17. *Id.*

18. *Id.*

19. *Id.*

20. *Id.*

allowed the client and the law firm to work with one another and proceed with litigation, when it otherwise may not have been possible.[21]

Burford Capital is funding a lawsuit filed by Petersen Energía Inversora and Eton Park Capital Management, two former minority shareholders of the oil company YPF, against the Argentinian government.[22] The suit is for the Argentinian government's failure to compensate them upon expropriating the company in 2012.[23] This case tested how the court would handle the intervention of litigation financers in large and complex matters.[24]

After the plaintiffs ultimately prevailed in the district court, analysts at Jefferies estimated that Burford Capital might be entitled to $6.3 billion from the verdict.[25] Despite its interest in the case, Burford Capital's name is absent from the lawsuit's caption. The district court forcefully rejected Argentina's efforts to inject Burford Capital into the proceedings.[26] In a footnote, the court justified in keeping Burford Capital behind-the-scenes in the matter, explaining that the defendant owes no more or less because of Burford Capital's involvement.[27] The court also opined Petersen being driven to bankruptcy, and forced to trade a large portion of its potential recovery for litigation funding, was all the more reason to award Petersen the full measure of its damages.[28] In a classic capitalist manner, Petersen had a need, Burford Capital met that need, and—if the matter plays out in Petersen and Burford Capital's favor on appeal and in its collection efforts—the benefits to both Petersen and Burford Capital from the TPLF transaction will be significant. In this context, Burford Capital's innovation and the Southern District of New York's footnote on TPLF should be celebrated as a victory for access to justice.[29]

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21. *Id.*

22. Alison Frankel, *This Billion-Dollar Case Against Argentina's YPF Wouldn't Exist Without Litigation Funding. Is That a Good Thing?,* REUTERS (Apr. 3, 2023), https://www.reuters.com/legal/litigation/column-this-billion-dollar-case-against-argentinas-ypf-wouldnt-exist-without-2023-04-03/.

23. *Id.*

24. Ben Rigby, *Burford-Backed Claimants Secure 'Extraordinary Win' After $16bn New York Judgment Against Argentina*, THE GLOB. LEGAL POST (Sept. 13, 2023), https://www.globallegalpost.com/news/burford-backed-claimants-secure-extraordinary-win-after-16bn-new-york-judgment-against-argentina-1221936278.

25. Stempel, *supra* note 15.

26. *Petersen Energía Inversora, S.A.U. v. Argentine Republic*, No. 15 Civ. 2739, 2023 WL 5827596, at *3 n.17 (S.D.N.Y. 2023).

27. *Id.*

28. *Id.*

29. *Id.*

II. THE REGULATORY VOID FOR TPLF CONTRACTS

In a recent landmark case, the Minnesota Supreme Court overturned its previous common law ban on TPLF, but left many unanswered questions and omitted any discussion of whether TPLF payments to consumers must actually be used to fund litigation.[30] In this case, Pamela Maslowski sustained personal injuries in a March 2012 car accident and hired the personal injury law firm, Schwebel, Goetz & Seiben, P.A., to pursue claims on her behalf.[31] The firm advertises a "no fee unless you win" contingency arrangement.[32] In May 2014, Maslowski signed an agreement with Prospect Funding Partners in which she was paid $6,000 in exchange for an interest in her personal injury action.[33] The agreement provided that Prospect could recover the principal amount plus 60% annual interest and a $1,425 processing fee, to be paid from the proceeds of Maslowski's personal injury case.[34] In March 2015, Maslowski's attorney filed a personal injury lawsuit, and the case was settled just four months later.[35]

The appellate courts' explanations of why Ms. Maslowski entered into the agreement included that she needed to pay for basic needs such as housing,[36] that she "faced economic hardship" following the car wreck, and she entered into the agreement with Prospect "to cover her living expenses while she continued to pursue her personal injury lawsuit."[37] The causation between the economic hardship and the car accident is attenuated by Maslowski's history in the Minnesota court system. Her history suggests that such financial hardship was already a pervasive issue for her. Five years before the car accident, Ms. Maslowski was involved in another case where the court noted "[t]he Maslowskis have filed for bankruptcy on a number of occasions in the past several years, a fact they failed to report on a mortgage application.

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30. *Maslowski v. Prospect Funding Partners LLC,* 944 N.W.2d 235, 241 (Minn. 2020).

31. *Id.* at 236.

32. SCHWEBEL, GOETZ, & SEIBEN, https://www.schwebel.com/ (last visited Sept. 17, 2023) (landing page of attorney website stating "no fee unless you win").

33. *Maslowski* (2020), 944 N.W.2d 235 at 236.

34. *Maslowski v. Prospect Funding Partners, LLC,* 890 N.W.2d 756, 759 (Minn. Ct. App. 2017).

35. Stipulation of Dismissal with Prejudice, Order and Judgment, *Maslowski v. Olson*, No. 27-CV-15-5208 (Minn. Civ. Ct. July 28, 2015).

36. *Maslowski v. Prospect Funding Partners, LLC*, 994 N.W.2d 293, 296 (Minn. 2023).

37. *Id.* at 297. *See also Maslowski, 890 N.W.2d at 759.*

In addition, Pamela Maslowski has been convicted of welfare fraud."[38] Maslowski also had a debt collection judgment against her in October 2011,[39] just five months before the car accident, and an eviction judgment in 2016.[40] The likely presence of a contingency fee attorney arrangement combined with Maslowski's history of economic hardship, unrelated to the car accident, raises questions about how the need for funding was related to prosecuting the personal injury case.

Shortly after her personal injury case was settled, Maslowski invoked the Minnesota prohibition on champerty to invalidate the contract with Prospect and avoid payment.[41] Prospect sued to recover the $14,108 they believed they were owed under the contract.[42] The court justified overturning its precedent that had outright banned TPLF on the basis that a prohibition of these contracts was no longer needed because of "[1] increased regulation of the legal profession, [2] the recognized legitimacy of certain champerty-adjacent arrangements . . . and [3] changes in the societal understanding of litigation as an economic asset rather than an evil to be avoided[]."[43] While these three justifications are reasonable in the abstract, none of them are particularly relevant to the current case. The Minnesota Supreme Court failed to explain why it held that increased regulation of the legal profession is relevant to TPLF, though perhaps regulation of the legal profession alleviates concerns in early common law that TPLF might fund frivolous lawsuits. [44] But whether society views litigation as an "economic asset" or an "evil"[45] is irrelevant to a loan that does nothing to facilitate the litigation being brought.

Ms. Maslowski's attorney does make the argument that public policy considerations should invalidate these types of contracts involving parties such as herself, though the Minnesota Supreme Court rejected this argument.[46] The court responded to Maslowski's public policy argument by holding that it "ignores the many sophisticated parties to whom this reasoning does not apply, such as those who seek

38. *Palmer et. al. v. 3M Co.*, No. C2-04-6309, 2007 WL 1879844, at *11 (D. Minn. June 19, 2007)

39. Transcript Judgment, *In re Grp. 41*, No. 82-CV-11-6068 (Minn. Cnty. Ct. Wash. Oct. 24, 2011).

40. Eviction Judgment, *Suneson v. Maslowski,* No. 82-CV-16-3788 (Minn. Cnty. Ct. Wash. Aug. 24, 2016).

41. *Maslowski* (2017), 944 N.W.2d 235 at 760.

42. *Id.*

43. *Maslowski* (2023), 994 N.W.2d 293 at 304.

44. *See* Hylton, *supra* note 7, at 705.

45. *See Maslowski* (2023), supra note 43.

46. *Maslowski* (2020), 944 N.W.2d 235 at 240.

commercial litigation financing and understand the risks involved with such agreements."[47] Through this reasoning, the court acknowledged how TPLF applied to different types of cases and how parties can be considerably different, but failed to split TPLF into subcategories for the purposes of regulation, as this paper proposes.

III. TPLF AS AN END-RUN AROUND USURY STATUTES.

It is difficult to understand how an agreement for a loan at 750% of the state's maximum allowable interest rate,[48] that does not fund the lawsuit itself and is not subject to meaningful regulation of the non-attorney parties to the agreement, is "legitimate." The court reasons that the commercialization of litigation funding has similar benefits to contingency fee arrangements,[49] accepting a long-standing argument made by legal scholars.[50] However, such arguments are premised on an assumption that both contingency fees and non-attorney financing serve similar purposes by funding litigation.[51] These assumptions do not extend to a plaintiff who takes out a loan but does not have out-of-pocket legal fees. In such cases, there is no meaningful similarity between the contingency fee arrangement that allows litigation to proceed and a loan that can be used for whatever the consumer decides to use it for. The purpose and actual use of the funding, rather than the mere coincidence of a consumer needing money while also prosecuting a personal injury case, should guide the classification of transactions as TPLF or ordinary loans, subject to statutory maximum interest rates.

Another purported justification of TPLF loans for non-legal expenses to personal injury plaintiffs is without them, plaintiffs "may be forced to settle for far less than what is due—simply because the person needs money now."[52] However, such a premise lacks any empirical finding that the amount plaintiffs stand to gain by delaying the settlement of their personal injury case exceeds the amount they stand to lose from the high interest rates. For example, a plaintiff may have a personal injury cause of action they reasonably believe to be valued at $12,000, have an immediate need for $6,000 to pay for living expenses, and receive a settlement offer of $6,000. Therefore, they may decide to

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47. *Id.* at 241.
48. *See* MINN. STAT. ANN. § 334.01 (West 2009).
49. *Maslowski* (2020), 944 N.W.2d at 239-40.
50. *See Radin*, *supra* note 1, at 75.
51. *Id.* at 69.
52. *Maslowski* (2023), 944 N.W.2d 293 at 306-07 (Moore, J., concurring).

reject the settlement offer and instead use TPLF to advance them the $6,000. A plaintiff in a case like this hypothetical might believe that TPLF allows them to proceed in their case that they otherwise would have been forced to settle for the unfair amount of $6,000.

However, even if the plaintiff achieves their desired outcome of a $12,000 personal injury settlement, exorbitant interest rates might ultimately cause the balance of the loan to exceed the value of the personal injury case. In Maslowski's case, her $6,000 loan ballooned to $14,108 by the time of Prospect's original petition[53] and could have continued to increase up to $25,245 according to the contract.[54] If the amount of the settlement is equal to or less than the TPLF balance, the personal injury settlement yields no money to the plaintiff.[55] As a result, the case may continue to be litigated, despite the parties otherwise preferring to settle.[56]

A personal injury plaintiff should have the same protections in borrowing money as the uninjured, at interest rates subject to maximums determined by state legislatures. In *Maslowski,* the borrower argued that the 60% interest rate was usurious and should be adjusted down to the state maximum rate of 8%.[57] The trial court accepted this argument, and the appellate court affirmed.[58] Their holdings pointed out that the risks to the lender could be measured, and their underwriting process provided some assurance that they would receive payment,[59] as ordinary loans often do. Potential loans can be analyzed to determine whether liability in the underlying personal injury case is clear and whether the damages are likely sufficient to recoup the loan.[60] However, the Minnesota Supreme Court reversed, holding that the usury statute could not have been intended by the legislature to be applied to litigation financing.[61]

The majority opinion separated TPLF from more traditional types of loans. It explained that the litigation financer bears the non-payment risk that can result from a plaintiff losing their underlying case, even

53. *Maslowski* (2017), 944 N.W.2d 235 at 761.

54. *Maslowski* (2022), 978 N.W.2d 447 at 452-53.

55. *Id.* at 459.

56. Alan Russo & Maria Castronuovo, *Social Inflation 101: Impacts on the Insurance Industry*, LEXISNEXIS PRACTICAL GUIDANCE, 1, 1 (2024), https://plus.lexis.com/api/permalink/e8037e35-64a5-43fb-bcb3-1b5626f0eed2/?context=1530671.

57. *Maslowski* (2022), 978 N.W.2d 447 at 457-58.

58. *Id.*

59. *Maslowski* (2023), 944 N.W.2d 293 at 298.

60. *See Echeverria,* No. 018666/2002, 2005 WL 1083704 at *4.

61. *Maslowski* (2023, 994 N.W.2d 293 at 304-05.

when the extent of that risk is nominal.[62] Yet, the court failed to address analogous risks stemming from traditional financing. Many other types of investments also carry risk that is incorporated into the value of the investment and the required interest rate.[63] Further comparison of the extent of risks for lenders in personal injury TPLF and the extent of risks for lenders in traditional loans would likely be a useful endeavor. In the Minnesota case, this question was left to the legislature, with a concurring opinion written to "invite the Legislature to consider regulation of the litigation financing industry in Minnesota."[64]

Without meaningful regulation, the limits of what financial transactions constitute TPLF are unclear. A company named RD Legal allegedly capitalized on that ambiguity by entering into contracts with victims of the September 11, 2001, terrorist attacks that had been awarded compensation from the federal government.[65] The federal government established a compensation scheme known as the Zadroga Fund, where payments were essentially guaranteed to certain victims and their surviving family members, but the payments took some time to be processed.[66] Since claimants receiving payment under the Zadroga Fund waived any rights to file a civil action for damages resulting from the September 11, 2001, attacks,[67] there were no underlying lawsuits. Moreover, by the time RD Legal got involved, the claimants' decision to waive any civil lawsuit had already been made.

Thus, the connection between the funding and the claimant's ability to pursue a legal matter was even more remote than in *Maslowski* because the claimants explicitly promised *not* to pursue litigation before taking out their loans from RD Legal. Interest rates under the RD Legal contracts were as high as 250%, with an assignment of future government payments serving as collateral.[68] In a civil action brought by the Consumer Financial Protection Bureau and the Attorney General for the State of New York, the government agencies alleged that Defendants RD Legal Funding engaged in deceptive and abusive acts and

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62. *Id.* at 307.

63. *See* Damodaran, *supra* note 6, at 3.

64. *Maslowski* (2023), 994 N.W.2d 293 at 305 (Moore, J., Concurring).

65. Complaint at 3:8, *CFPB v. RD Legal Funding, LLC*, No. 1:17-CV-00890 (S.D.N.Y. Feb. 17, 2017).

66. Air Transportation Safety and System Stabilization Act, Pub. L. No. 107-42, § 403 (2001).

67. *Id.* § 403(c)(3)(B)(i).

68. Jody Godoy, *Litigation Funder to Pay $1 to Settle CFPB, N.Y. Lawsuit Over 9/11 Fund*, REUTERS (Nov. 23, 2022), https://www.reuters.com/legal/litigation/litigation-funder-pay-1-settle-cfpb-ny-lawsuit-over-911-fund-2022-11-23/.

practices in connection with offering or providing extensions of credit to consumers who had been awarded settlements.[69]

The lawsuit further alleged that RD promised to "cut through the red tape," a statement alleged to be deceptive, as RD Legal had no means to accelerate fund disbursement from the Zadroga fund.[70] One of the government's causes of action alleged that the contracts functioned as loans under state law and were therefore subject to an interest rate cap of 16%, which the agreements far exceeded.[71] RD disputed the government's theories and claimed that its products were "sales of legal receivables."[72] The lack of legal principles on TPLF for the government to leverage in prosecuting their case against RD Legal became apparent in the ultimate resolution of the case, which was a $1 settlement.[73] If there was any question about whether this litigation served as a deterrent to engaging in these types of practices, such a question can perhaps be answered with a visit to RD's website, which states that they will advance money on virtually any type of settlement.[74] This implies that it continues to focus on TPLF loans in cases that have already settled.

IV. CONCLUSION

States can expand access to the courts by liberally allowing business-to-business TPLF, while restricting consumer TPLF to maximum interest rates that are determined by state legislatures and factor the true level of risk taken on by litigation financing companies. This will prevent plaintiffs from continuing to be exploited by unscrupulous funding companies because of their status as a carve-out to usury statutes. A comprehensive model statute should limit the definition of "funding" in TPLF as payments used to pay for attorney fees, expert fees, court costs, and investigation of legal matters. All related terms, such as assignments and sales of legal receivables, should also be defined in the model statute in such a way that prevents them from being used to end-run around the statute. The statute should

69. *CFPB v. RD Legal Funding, LLC*, No. 1:17-CV-00890 at 2:6.
70. *Id.* at 10:45.
71. *Id.* at 11:53.
72. Godoy, *supra* note 68.
73. *Id.*
74. RD Legal Funding, LLC, *Post-Settlement, Award or Judgment Funding: Convert Your Settled Case Into Immediate Cash*, RD LEGAL FUNDING, https://rd-legal-funding.webflow.io/plaintiff-post-settlement-funding (last visited Oct. 3, 2024).

provide that funding for all other items, such as paying a plaintiff's living expenses or replacing income resulting from lost earning capacity, are considered ordinary loans, and that marketing such ordinary loans with terms like "litigation funding" is unlawfully deceptive. Through this framework, *Petersen* would be allowed to proceed exactly as it has been, while *Maslowski* and *RD Legal* would be treated as ordinary loans, subject to statutory restrictions on interest rates and deceptive marketing. This nuanced statute can appropriately balance the numerous competing interests in the long-standing debate about the desirability of TPLF.