Contingent Advances

Are They Subject to Usury Law?

By J. Leonard Hyman and Paul A. Frumkin

The idea that a person should receive fair compensation for an injury caused by actionable conduct should be non-controversial. Hopefully we all believe that fair compensation, which is the rule of law, should also result as a matter of fact. But it is hard to deny that the odds are often stacked against an injured plaintiff. Frequently, the plaintiff's earning power has been diminished or destroyed, but his need for current income is great. From the insurer's viewpoint, if a payment must be made, it is fiscally advantageous to make that payment later rather than sooner, because the money, and earnings on it, can be kept during the interim. How, then, does an injured, out-of-work plaintiff fund himself pending resolution of his litigation?

Fast Facts

- $ Funding companies typically attempt to skirt usury laws by giving "contingent advances" rather than loans.
- $ Funding companies' documents typically don't state a rate of interest, but instead state amounts that must be repaid within different given time frames.
- $ The Ohio Court of Appeals held recently that a transaction is a loan if the event excusing payment is so improbable as to convince that there is no real hazard. The question is whether the reasoning of the Ohio appellate court is consistent with Michigan law.

The rule against funding another's litigation is of ancient lineage, far predating any code of lawyers' conduct. It finds its roots in the common law prohibition against champerty, which "was defined to be 'a bargain with a plaintiff or defendant to divide the land or other thing sued for between them if they prevail at law; the champertor agreeing to carry on the suit at his own expense.'"[1] In feudal England, spurious claims to land were fomented in courts, which could be assumed to be partial to local lords. Because these spurious suits were often successful, in these partial courts, the judicial system itself was viewed with hostility. Encouraging such suits was therefore considered quasi-criminal, and came to be known as champerty, a word that has its root in the word "champion," which originally was a person who defended or fought for the rights of another. Champerty, as a defense to a contract, was long ago abrogated by the predecessors of MCLA 600.919(1). Nonetheless, the rule against champerty still applies to some aspects of the attorney-client relationship.[2]

If lawyers are prohibited from providing their clients with financial assistance other than funding litigation costs, may third parties lawfully support a plaintiff-litigant until his day in court?

No doubt, under the waterline, families and friends of injured plaintiffs have done just that for many years. But what if unrelated third parties decided to sustain such plaintiffs, above board, in a for-profit business venture? The past several years have witnessed the emergence of just this kind of company. Bearing names such as "Future Settlement," "Resolution Settlement," "Interim Settlement Funding," and "LawFunds," these companies offer to provide funds to injured plaintiffs pending resolution of their litigation. In exchange, the plaintiff agrees to assign some portion of the litigation proceeds to the funding company.

These companies claim that they offer a needed and helpful service by providing funds to low-income plaintiffs for life's necessities until the conclusion of their cases. These funding companies say that without their services, plaintiffs would be forced to settle their claims for grossly inadequate compensation. Thus, the companies claim they are performing a public service by leveling the playing field between deserving and needy plaintiffs on the one hand, and monied, hardball-playing defendants on the other hand.

Assuming that justice is best achieved when the litigants have roughly similar resources, it does seem that some type of plaintiffs' funding could serve the public interest by decreasing the disparity between litigants' resources, thereby achieving "better" justice on a more level playing field. But are today's litigation-funding businesses the plaintiffs' knights in shining armor they claim to be, or do they also exploit the needy plaintiff like the insurance companies they decry? While it seems that some sort of business could bring needed help to necessitous plaintiffs on a fair basis, it is far from clear that today's funding companies actually do so.

These funding companies typically attempt to skirt usury laws. Because loans are characterized by an absolute obligation to repay, these companies say they don't make loans, but rather contingent advances that are repayable only in the event the plaintiff's litigation succeeds. Their documents avoid using the language of loans. The plaintiff is not a "borrower," but a "transferor" of part of his interest in his litigation. The funding company is not a "lender," but a "transferee." Their documents typically don't state a rate of interest, but instead state amounts that must be repaid within different time frames. When the interest rates are calculated, however, they are often eye-popping.

A case currently in the Michigan Court of Appeals[3] demonstrates a funding company at work. The plaintiff, Mary Curry, was seriously injured in a chain automobile collision and witnessed her best friend burn to death before Curry herself was pulled from her vehicle. The trucking company had multiple layers of insurance and admitted liability. A damages-only trial was conducted, and the jury returned a multi-million dollar verdict.

In April of 2000, more than a year after the jury returned its verdict, and 10 days after entry of the multi-million dollar judgment, Curry entered into her first transaction with the company. She received $75,000, and agreed to pay the company $450,000 if she could repay within 18 months. After 18 months, another $75,000 would be added every six months. These numbers reflect annual interest rates of 333 percent and 200 percent, respectively. The transaction documents do not state any interest rate.

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Approximately two months after the first transaction, Curry received an additional $100,000 in a transaction that was said to supersede and replace the first transaction. For her total of $175,000, Curry agreed to pay $1,050,000 if she could pay within 16 months, and to pay another $175,000 for every six months thereafter until payment was made. These numbers reflect annual interest rates of 370 percent and 200 percent, respectively. Again, the documents for this transaction do not reveal the interest rates.

The documents for the second transaction had an alternative payoff, providing that if at the time of payment, the amount due the company was less than 10 percent of the judgment or settlement, Curry would pay 10 percent of her judgment or settlement.

Because Curry, at the time of this second transaction, already had a judgment for some $27 million, the funding company expected to receive $2.7 million for the $175,000 it had given Curry less than one year earlier. This works out to an annual interest rate of some 15,000 percent, a figure that again was not revealed anywhere in the documentation.

In April of 2001, Curry and the defendant trucking company stipulated to entry of judgment in the amount of $4,786,144. Because of the reduction in judgment, the funding company did not pursue its alternative 10 percent payoff provision, but it did sue Curry in Oakland Circuit Court, claiming entitlement to $887,500 for the $175,000 it had given her a little more than one year earlier. Curry defended on the bases of usury, unconscionability, and violation of the Consumer Protection Act.

Hopefully, the Court of Appeals' decision will bring needed predictability to these transactions, while also maintaining the protection for the necessitous and destitute borrower, which the usury laws are designed to provide.

The circuit court agreed with the company that an advance of money is a loan only where there is an absolute obligation to repay,[4] but the court further held that while the contract documents were drafted as if a contingency existed, the facts showed that, in reality, the purported contingent event was all but assured. Even before Curry's first transaction with the company, the defendant, with multiple layers of insurance, had stipulated to liability, and Curry's skilled and high-profile lawyer had tried the damages-only trial to a jury, which had returned a verdict of some $27 million. The circuit court looked not at the form or color of the transaction, but rather at its nature and substance. "[A] court must look squarely at the real nature of the transaction, thus avoiding so far as lies within its power, the betrayal of justice by the cloak of words, the contrivances of form, or the paper tigers of the crafty."[5] The circuit court granted Curry's motion for summary disposition on her usury defense[6] and limited the company's recovery to the principal amount of the loans.[7]

On appeal, the funding company maintains that because the obligation to repay was contingent upon successful resolution of Curry's case, the obligation to repay was not absolute, and therefore the transaction could not be a loan subject to the usury laws. This case clearly raises the question just how "absolute" an obligation to repay money must be before a transaction should be characterized as a loan. Taken to its extreme, can a transaction that requires repayment only in the event the world still exists on the day for repayment, escape the usury laws because repayment is not "absolute"? On appeal, the parties address three out-of-state decisions: *Rancman v Interim Settlement Funding Corp,* 2001 W L 1339487 (Ohio App 2001), lv to appeal granted, 94 Ohio St 3d 1485; 763 NE2d 1184 (Table) (2002); *Kraft v Mason,* 668 So 2d 679 (Fla App 1996); and *Dopp v Yari,* 927 F Supp 814 (D NJ 1996).

In *Rancman,* the plaintiff filed suit to recover her no-fault uninsured motorist benefits. Pending this litigation, the plaintiff received $7,000 from a funding company. Plaintiff thereafter settled her claim against her no-fault insurer for $100,000. Against Rancman's claim that the transaction was a usurious loan, the funding company responded that the transaction was not a loan but was a "contingent advance" to which usury laws did not apply. The Ohio Court of Appeals held that a transaction is a loan if the event excusing payment is so improbable as to convince that there is no real hazard. Under the facts of the case, the Ohio court held nonpayment was so improbable that the transaction was a loan and subject to the usury laws.

On appeal, the funding company says that *Rancman* is contrary to Michigan law, which, it says, requires an absolute obligation to repay. Curry's appellate brief, citing *Boyd v Layher,* 170 Mich App 93; 427 NW2d 593 (1988), argues that Michigan's "absolute obligation" rule is not applied literally, but functionally. In that case, Ms. Boyd needed money for living expenses for herself and two handicapped children. Although she was a land contract vendor, the purchaser had not been making the payments. The lender cast the transaction as an assignment of Boyd's land contract interest, with a reassignment back to Boyd if the lender collected a stated amount. If the lender did not collect the stated amount, he could pay Ms. Boyd $5,200 (less taxes due) and her interest in the property would terminate.

The defendant-lender claimed that the transaction was not a loan because Boyd was not absolutely required to repay. The court, however, held that because the lender was a purchaser of a greater sum of money to be paid back in the future, the lender was not a "purchaser" at all, but a lender. But the key to the case appears to be the fact that Ms. Boyd's land contract vendor's interest was so much more valuable than the total to be repaid the lender, there was no real probability that she would not pay the loan, even if she was not "absolutely" required to pay it off. Accordingly, *Rancman* may not be contrary to Michigan law as expressed in *Boyd.*

Curry's funding company also contends on appeal that *Kraft v Mason,* 668 So 2d 679 (Fla App 1996), supports its position that there was no loan. But in *Kraft,* the amount the borrower would have to pay to the lender did not change over time—it remained, per the parties' agreement, a fixed percentage. Thus, without a time component, there was no way to calculate an interest rate. Further, the *Kraft* lender was unsophisticated and the agreement was drafted by the borrower. The other case the funding company relies upon, *Dopp v Yari,* 927 F Supp 814 (D NJ 1996), also involved payment of a fixed percentage of the litigation proceeds regardless of a time factor, and so an interest rate calculation again was impossible. But perhaps even more importantly, both *Dopp* and *Kraft* were decided under Florida law, which provides that "usury is largely a matter of intent, and is not determined by the fact that the lender actually receives more than the law permits . . . ."[8] Contrary to *Dopp* and *Kraft,* Michigan law provides that intent to evade the usury laws is irrelevant to a determination whether usury exists.[9]

While there might be an appropriate time, place, and manner of assisting plaintiffs during the pendency of their litigation, it is far from clear that the current example is one that ought be followed. It could be argued that quite unlike a plaintiff's champion, the funding company also seeks to take advantage of the necessitous plaintiff, albeit it in a different fashion than an insurance company, which seeks to delay and minimize payment.

Certainly, given the particular and involved factual pattern in this case, coupled with the arguable dichotomy in Michigan case law regarding whether the absolute repayment obligation should be applied literally or functionally, the Court of Appeals could go in many different directions, and even then provide only narrow guidance. Hopefully, the Court of Appeals' decision will bring needed predictability to these transactions, while also maintaining the protection for the necessitous and destitute borrower, which the usury laws are designed to provide. ✦

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Footnotes

1. *Lehman v Detroit, GH&M Ry Co,* 180 Mich 362, 365; 147 NW 628, 629 (1914), citing 4 Bouvier 236 and *Backus v Byron,* 4 Mich 535. See also *Smith v Childs,* 198 Mich App 94, 98; 497 NW2d 538, 540 (1993).
2. This rule is currently found in MRPC 1.8(e), and formerly the prohibition was found in the Model Code's Disciplinary Rule 5-103(B).
3. *Lawsuit Financial, LLC, v Curry, et al.,* Mich Ct App No. 243011.
4. See, e.g., *Blackwell Ford, Inc v Calhoun,* 219 Mich App 203; 555 NW2d 856 (1996).
5. *Wilcox v Moore,* 354 Mich 499, 504; 93 NW2d 288, 291, also quoted in *Boyd v Layher,* 170 Mich App 92, 97; 427 NW2d 593, 595 (1988).
6. Unless a statutory exception applies, the maximum legal interest rate is 7 percent. MCLA 438.31. Criminal usury is defined as any rate of interest exceeding 25 percent. MCLA 438.41.
7. MCLA 438.32.
8. *Kraft v Mason,* 668 So 2d at 684 (Fla App 1996).
9. *Thelen v Ducharme,* 151 Mich App 441; 390 NW2d 264 (1986); *Paul v US Mutual Financial Corp,* 150 Mich App 773; 389 NW2d 487 (1986).