

Department of Legislative Services  
 Maryland General Assembly  
 2011 Session

FISCAL AND POLICY NOTE

House Bill 873  
 Judiciary

(Delegate Dumais, *et al.*)

Maryland Civil Litigation Funding Act

This bill establishes that the contingent right to receive a portion of the potential proceeds of a bona fide civil or statutory claim or cause of action (“legal claim”) is assignable and an assignment of that right is valid for the purposes of obtaining funding from a “civil litigation funding company.” A funding company must register with the Secretary of State. Nonrecourse civil litigation funding is not a loan and is not subject to the restrictions or provisions governing loans.

Fiscal Summary

**State Effect:** Minimal increase in general fund revenues from expanded application of civil and criminal penalties under the Maryland Consumer Protection Act (MCPA). General fund expenditures increase by \$84,300 in FY 2012 for the Division of Consumer Protection of the Office of the Attorney General (DCP) to hire one part-time assistant Attorney General and one part-time investigator to assist with the regulatory duties contained in the bill. The Office of the Secretary of State can comply with the bill’s requirements using existing resources. General fund revenues increase from registration fees set to offset expenses for DCP and the Secretary of State.

(in dollars)	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
GF Revenue	\$84,300	\$102,600	\$107,700	\$113,000	\$118,500
GF Expenditure	\$84,300	\$102,600	\$107,700	\$113,000	\$118,500
Net Effect	\$0	\$0	\$0	\$0	\$0

*Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect*

**Local Effect:** Minimal increase in local revenues due to civil and criminal penalties for those cases heard in the circuit courts.

**Small Business Effect:** Potential minimal impact on civil litigation funding companies that qualify as small businesses who are able to engage in business transactions with Maryland residents as a result of the bill.

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## **Analysis**

**Bill Summary:** The bill also (1) establishes content requirements for nonrecourse civil litigation funding contracts; (2) specifies a fee schedule for nonrecourse civil litigation funding; (3) establishes registration and reporting requirements for civil litigation funding companies; (4) clarifies that specified rules of professional conduct apply to an attorney representing a consumer who has obtained funding and is in a dispute with the funding company; (5) specifies that communication between an attorney representing a consumer in a legal claim and a funding company does not limit or affect any applicable statutory or common law privilege; (6) specifies that funding may not be used to pay for attorney's fees or costs; (7) prohibits the proceeds of any legal claim from being purchased more than three times after the initial funding; (8) specifies that a funding company is only entitled to receive funds out of proceeds of a legal claim, may only be paid to the extent there are available proceeds from a legal claim, and may not be paid anything if there are no available proceeds from a legal claim; (9) requires funding companies to adhere to specified standards of professional practice/behavior; and (10) requires the Secretary of State to adopt certain regulations and submit an annual report.

A "civil litigation funding company" is a person that enters into a nonrecourse civil litigation funding transaction with a consumer. The bill defines a "consumer" as a person who (1) resides or is domiciled in the State; (2) has a pending legal claim; (3) elects to enter into a transaction for nonrecourse civil litigation funding in person or electronically; and (4) has legal representation at the time he/she enters into the funding transaction.

In nonrecourse civil litigation funding, a consumer with a pending legal claim assigns the right of a funding company to receive a portion of the potential proceeds of a settlement, judgment, award, or verdict obtained from the consumer's legal claim. In return for this right, the funding company provides the consumer with a set amount of funds and also may assess other fees. If there are insufficient proceeds from the claim to pay the funding company in full, the company is to be paid only to the extent possible under the available proceeds. A civil litigation funding company may not be paid anything if there are no available proceeds from a legal claim.

### *Content Requirements for Contracts for Nonrecourse Civil Litigation Funding*

Contracts for nonrecourse civil litigation funding must contain the total dollar amount of funds to be paid to the consumer, an itemization of one-time fees, and a schedule of the

total dollar amount being assigned by the consumer to the funding company every 6 months over the 36-month period following the date on which the funding company provided funding to the consumer (funding date). The contract must also contain a notice of the consumer's right to cancel the contract without penalty within five business days from the funding date. The notice must be in the format specified in the bill.

The bill also requires contracts to contain several statements that must meet the content and formatting requirements specified in the bill. Contracts must include the statements listed below.

- The funding company agrees that it has no role in the handling of the consumer's legal claim, including any settlement or resolution of the claim. Any decisions made regarding the handling of the consumer's legal claim are to be made by the consumer and the consumer's attorney.
- The funding company agrees that it will only accept an assignment of the amount of the *potential proceeds* from the consumer's legal claim, not an assignment of the consumer's legal claim. The funding company has no right to pursue the legal claim on behalf of, or instead of, the consumer.
- The funding company is only to be paid from the proceeds of the consumer's legal claim. The funding amount and agreed upon fees must only be paid from the proceeds of the legal claim and only to the extent that there are available proceeds from the consumer's legal claim. The consumer will not owe anything to the funding company if there are no available proceeds from the legal claim.
- A consumer must not sign the contract until he/she reads it completely. A consumer must not sign the contract if it contains any blank spaces, and is entitled to a filled-in copy of the contract. A consumer should obtain legal advice and advice from tax, financial, or benefit planning professionals prior to signing the contract. A consumer acknowledges that his/her attorney in the legal claim has not provided any tax, public or private benefit, or financial planning regarding the civil litigation funding transaction.

A contract must also contain a written acknowledgment by the consumer that the consumer has reviewed the contract in its entirety and written acknowledgments by the consumer's attorney that (1) all proceeds of the legal claim will be disbursed through the attorney's trust account or through a settlement fund established by the defendant in the legal claim to receive and distribute the proceeds of the legal claim on behalf of the consumer; and (2) the attorney has reviewed the contract and will comply with the consumer's written instructions regarding remittance of payment to the funding company upon resolution of the claim.

Contracts for Spanish-speaking consumers must comply with specified translation requirements.

### *Assessment of Fees*

The total dollar amount assigned by a consumer to a civil litigation funding company must be limited to the funding amount and the fees established by the bill's fee schedule, which is shown below.

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<b><u>Resolution Date</u></b>	<b><u>Maximum Fee</u></b>
Up to 6 months after the funding date	0.45 times the funding amount
Between 6 months and 1 day after the funding date and 12 months after the funding date	0.8 times the funding amount
Between 12 months and 1 day after the funding date and 18 months after the funding date	1.5 times the funding amount
Between 18 months and 1 day after the funding date and 24 months after the funding date	1.75 times the funding amount
Between 24 months and 1 day after the funding date and 36 months after the funding date	2.0 times the funding amount

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No additional fees may be collected for any period exceeding 36 months after the funding date. A civil litigation funding company may not collect administrative fees in excess of 8% of the amount received by the consumer at the time of funding.

### *Professional Standards*

If a dispute arises between the consumer and the funding company, the responsibilities of the attorney representing the consumer in the underlying legal claim must be consistent with the Maryland Lawyers' Rules of Professional Conduct. A communication between the consumer's attorney and the funding company does not limit, waive, or abolish any applicable privilege under statute or common law, including attorney-client privilege and the work-product doctrine.

A civil litigation funding company may not enter into a contract for nonrecourse civil litigation funding with a consumer who is not represented by an attorney. Funding  
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companies may not pay or offer commissions or referral fees to health professionals, attorneys, or employees of law firms or health professionals for referring consumers to the funding company. A funding company is also prohibited from accepting any commissions, referral fees, or rebates from these individuals other than the amount agreed to be paid to the funding company from the proceeds of the legal claim as established in the company's contract with the consumer.

Civil litigation funding companies may not advertise false or intentionally misleading information regarding the company's product or services and may not offer single premium credit life, disability, or unemployment insurance that is to be financed through a civil litigation funding transaction.

A funding company is prohibited from providing funding to a consumer who has previously sold and assigned a portion of a legal claim's potential proceeds to another civil litigation funding company without first making payment to or purchasing the other funding company's funded amount and contracted fees.

Funding may not be used to pay for attorney's fees or cost and the proceeds of any legal claim may not be purchased more than three times after the initial funding.

### *Registration*

A civil litigation funding company is prohibited from doing business in the State unless the company is registered with the Secretary of State. A funding company must submit an application for registration with the Secretary in the form required by the Secretary. The application must contain the information necessary for the Secretary, with the assistance of DCP, to make an evaluation of the character, fitness, and financial responsibility of the company to determine that the business will be operated in accordance with the bill's provisions. The Secretary must require a funding company to submit the following items: (1) a copy of the company's articles of incorporation, articles of organization, certificate of limited partnership, and other organizational documents; (2) proof that the company has a registered agent in the State in accordance with State law; and (3) proof of a surety bond or irrevocable letter of credit issued and confirmed by a financial institution legally authorized to conduct business in the State that is double the amount of the largest funding in the State in the previous calendar year or \$50,000, whichever is greater.

A funding company may apply to renew a registration by submitting an application for renewal to the Secretary of State according to the Secretary's requirement. An application for renewal must contain current information on all matters required in an original application for registration. An application for registration or renewal is a public record.

The Secretary, in consultation with DCP, may set application fees to sufficiently recover the costs of administering the bill's provisions, including costs incurred by DCP. An application for registration or renewal must be accompanied by the application fee. The Secretary may issue a temporary certificate of registration while an application for registration or renewal of registration is pending.

The Secretary must issue a certificate of registration to a funding company that complies with the application/registration requirements. However, the Secretary may refuse to issue a certificate of registration if the Secretary determines that the character, fitness, or financial responsibility of the funding company warrants belief that the business will not be operated in accordance with the bill's provisions. The Secretary may suspend, revoke, or refuse a funding company's registration if the company engages in conduct that would have justified a denial of registration. However, such action may only be taken after proper notice and an opportunity for a hearing in accordance with the Administrative Procedure Act.

If the Secretary denies, suspends, revokes, or refuses to renew a certificate of registration, the Secretary must notify DCP. DCP is authorized to take appropriate enforcement action under MCPA.

#### *Reporting Requirements and Regulations*

On or before September 1 of each year, each registered civil litigation funding company must report the following information from the previous fiscal year to the Secretary of State in a form prescribed by the Secretary: (1) the number of nonrecourse civil litigation funding transactions with consumers in the State and the amount of funds paid to each consumer; (2) the fees charged to consumers; and (3) the number of cases in which the amount realized by the company was less than the amount stated in the contract with the consumer and the amount received by the company in each of these cases.

The Secretary of State must report to the House Judiciary and Senate Judicial Proceedings committees by December 1 of each year on (1) the implementation of the licensing of civil litigation funding companies; (2) the aggregate information reported to the commissioner by funding companies; and (3) the status of any consumer complaints against funding companies. The commissioner must submit the first report by December 1, 2011. The Secretary of State must adopt regulations to carry out the bill's requirements, including a process to address consumer complaints.

**Current Law:** The Maryland Consumer Loan Law (MCLL) consists of Title 11, Subtitle 2 of the Financial Institutions Article and Title 12, Subtitle 3 of the Commercial Law Article. Under MCLL, a "loan" is defined as any loan or advance of money or credit made under the credit provisions of MCLL. Under MCLL, the Commissioner of

Financial Regulation is responsible for the licensing and regulation of consumer loans and advances in the State. A person may not make a loan, receive an application for a loan, or allow any note or contract for a loan to be signed without being licensed by the State. Applicants must meet specified requirements, including having minimum liquid assets. A separate license is required for each place of business where a person makes a loan or transacts any business under MCLL. An applicant must file a surety bond with the commissioner along with the application. The surety bond is filed for the benefit of the State and any person that has a cause of action against the applicant under MCLL. The commissioner has the authority to issue cease and desist orders to any licensee or other person engaging in a course of conduct that results in an evasion or violation of MCLL or any rule or regulation adopted under MCLL.

Under Maryland law, the maximum permissible annual interest rate (“usury cap”) for small loans (under \$6,000) varies with the amount of the loan, up to 33%.

The Maryland Lawyers’ Rules of Professional Conduct provide a framework of behavior for legal professionals in the State. The rules set boundaries on the activities in which an attorney may engage and the role an attorney may play in specified situations. While the rules do permit contingent fee agreements (except in criminal cases and some family law cases), the rules generally prohibit an attorney from providing financial assistance to a client under other circumstances. Lawyers are also prohibited from accepting compensation for representation from someone other than the client, unless the client provides informed consent, confidentiality of information related to the representation is maintained, and there is no interference with the lawyer-client relationship or the lawyer’s independence of professional judgment. A lawyer is also prohibited from acquiring a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for a client, other than (1) a lien authorized by law to secure the lawyer’s fee or expenses; and (2) a contract with a client for a reasonable contingent fee arrangement in a civil case.

DCP is responsible for enforcing MCPA and investigating the complaints of aggrieved consumers. DCP may attempt to conciliate the matter, hold a public hearing, seek an injunction, or bring an action for damages. A merchant who violates MCPA is subject to a fine of up to \$1,000 for the first violation and up to \$5,000 for each subsequent violation. In addition to any civil penalties that may be imposed, any person who violates MCPA is guilty of a misdemeanor and, on conviction, is subject to a fine of up to \$1,000 and/or imprisonment for up to one year.

**Background:** The Office of the Commissioner of Financial Regulation is responsible for licensing and regulating mortgage lenders, brokers, servicers and originators, sales finance companies, consumer loan companies, money transmitters, check cashers, installment loan lenders, credit reporting agencies, consumer debt collection agencies,

and debt management service providers. The office also regulates and supervises State-chartered financial institutions including State-chartered banks, credit unions, and trust companies. Supervision includes periodic on-site evaluations as well as off-site monitoring programs.

In March 2009, the Commissioner of Financial Regulation issued a summary cease and desist order to Oasis Legal Finance, LLC (“Oasis”) for engaging in the business of making loans or advances to Maryland consumers without the proper licenses under Maryland Law. Oasis meets the definition of a “civil litigation funding company” under the provisions of this bill. The order was issued as a result of two complaints and an investigation by the commissioner. Oasis denied the allegations in the summary order and asserted that the transactions it entered into are classified as nonrecourse civil litigation funding transactions, not “loans or advances” under Maryland law. Oasis also denied liability under the MCLL or any other State law or regulation. In an effort to resolve the matter and avoid further litigation by both parties, Oasis reached a settlement agreement with the commissioner in August 2009 and waived its right to a hearing before the Office of Administrative Hearings (OAH). The agreement was not an admission of liability or violation of Maryland law by Oasis. The agreement contains several mutual promises, including:

- that the commissioner will vacate the cease and desist order and withdraw the scheduled hearing from the OAH docket;
- that the commissioner agrees not to bring any enforcement action against Oasis for any conduct related to the investigation that generated the cease and desist order;
- an acknowledgement by Oasis that it has not engaged in any new transactions described in the cease and desist order since the date it received the order and agrees not to do business in Maryland as long as the current law is in effect or until it gets licensed under MCLL (which the commissioner alleges it must);
- that the commissioner will permit Oasis to conclude all pending transactions with Maryland residents by collecting the funded amount plus a rate of return that does not exceed State usury caps; and
- an agreement by Oasis agrees to pay a settlement amount of \$105,000.

On February 4, 2011, the Commissioner of Financial Regulation issued a summary cease and desist order to American Legal Funding, LLC in response to consumer complaints. According to the order, the company was engaged in the practice of making loans without being properly licensed in the State. While the company’s written agreements



with the consumers did not provide the applicable interest rates, the commissioner concluded that based on the repayment schedule in the agreements, the consumers' cash advances were subject to annual interest rates between 177% and 22,701%, depending on when the advances were repaid.

**State Expenditures:** General fund expenditures increase by \$84,300 in fiscal 2012, which accounts for the bill's October 1, 2011 effective date. This estimate reflects the cost of hiring one part-time assistant Attorney General and one part-time fraud investigator for DCP to assist the Secretary of State in regulating civil litigation funding companies.

While DCP specializes in consumer rights, the bill requires DCP to take a more active role with respect to a particular industry by requiring DCP to assist the Secretary of State in evaluating the character and fitness of applicants. It is also likely that DCP will be involved in investigations of consumer complaints and the development of regulations. While it is unclear how many civil litigation funding companies will pursue registration in Maryland the start-up tasks associated with establishing a regulatory mechanism within DCP to handle the bill's requirements will require additional personnel.

This estimate includes a salary, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Position – FTE	1
Salary and Fringe Benefits	\$75,050
Operating Expenses	<u>9,278</u>
<b>Total FY 2012 State Expenditures</b>	<b>\$84,328</b>

Future year expenditures reflect a full salary with 4.4% annual increases and 3% employee turnover as well as 1% annual increases in ongoing operating expenses.

The Office of the Secretary of State advises that it can comply with the bill's requirements using existing resources. Legislative Services concurs with this assessment given DCP's extensive role in the regulation process.

**State Revenues:** General fund revenues increase from registration fees for civil litigation funding companies. The bill authorizes the Secretary of State to set registration fees at a rate necessary to recoup the costs incurred by the Secretary of State and DCP in complying with the bill's requirements. While the Secretary of State is not required to

assess registration fees, this estimate assumes that a fee will be assessed to defray the expenses of the new program requirements imposed by the bill. Minimal increase in general fund revenues due to the bill's civil and criminal penalty provisions.

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### **Additional Information**

**Prior Introductions:** SB 831 of 2010, a similar bill, received a hearing in the Senate Judicial Proceeding Committee, but no further action was taken. Its cross file, HB 1331, received a hearing in the House Judiciary Committee but was subsequently withdrawn.

**Cross File:** None.

**Information Source(s):** Office of the Attorney General (Consumer Protection Division), Judiciary (Administrative Office of the Courts), Department of Legislative Services

**Fiscal Note History:** First Reader - March 1, 2011  
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