

Department of Legislative Services
Maryland General Assembly
2010 Session

FISCAL AND POLICY NOTE

Senate Bill 831

(Senators Forehand and Miller)

Judicial Proceedings

Civil Litigation Funding

This bill establishes that the contingent right to receive an amount of the potential proceeds of a 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 be licensed by the Commissioner of Financial Regulation in accordance with the Maryland Consumer Loan Law (MCLL), but may use a line of credit from a regulated financial institution instead of the surety bond licensees are required to submit with an application for a license to make loans. However, nonrecourse civil litigation funding is not a loan and is not subject to the restrictions or provisions governing loans. A civil litigation funding company is not required to have a resident office in the State.

The bill also (1) establishes content requirements for nonrecourse civil litigation funding contracts; (2) imposes time limits for fees assessed by funding companies and limits on how frequently fees may be compounded; (3) 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; (4) 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; and (5) requires funding companies to adhere to specified standards of professional practice/behavior.

Fiscal Summary

State Effect: Potential minimal increase in general fund revenues from licensing fees for civil litigation funding companies. General fund expenditures increase by \$51,279 in FY 2011 and each year thereafter for the Office of the Commissioner of Financial Regulation to hire one financial examiner to assist the office in meeting the requirements of the bill.

(in dollars)	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
GF Revenue	-	-	-	-	-
GF Expenditure	\$51,300	\$64,100	\$67,100	\$70,400	\$73,800
Net Effect	(\$51,300)	(\$64,100)	(\$67,100)	(\$70,400)	(\$73,800)

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

Local Effect: None. The bill is not expected to materially affect local finances.

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.

Analysis

Bill Summary: 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 resides or is domiciled in the State and who elects to enter into a transaction for nonrecourse civil litigation funding in person or electronically. Funding transactions may be processed and completed by electronic means.

In nonrecourse civil litigation funding, a consumer with a pending legal claim assigns the right of a funding company to receive an amount of the potential proceeds of a settlement, judgment, award, or verdict obtained in the portion of the proceeds 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, and the consumer is not liable for any remaining amount that may be due to the funding company, unless the consumer violates the terms of the contract.

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 42-month period following the date of the contract. The contract must also contain a notice of the consumer’s right to cancel the contract without penalty within five business days from the date on which the consumer received funds from the company. 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 consumer will not owe the funding company any money if there are insufficient funds from the claim's proceeds to pay the funding company in full, unless the consumer violates the terms of the contract.
- 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) the attorney is being paid on a contingency basis in accordance with a written fee agreement; (2) 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 (3) 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

A civil litigation funding company may only assess fees against the consumer for a period of 42 months from the date of the contract with the consumer. Fees may not be compounded more frequently than every 6 months during the 42-month period. The company must include all charges payable directly or indirectly by the consumer when calculating the annual percentage fee or rate of return. A company must compute the rate based only on the amounts actually received by a consumer.

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 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 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.

Unless otherwise stipulated in a written agreement between the civil litigation funding company and the consumer, a funding company is also prohibited from knowingly providing funding to a consumer who has previously sold and assigned an amount of the legal claim's proceeds to another civil litigation funding company without first buying out the other company's entire accrued balance.

Reporting Requirements and Regulations

Each civil litigation funding company must report the following information annually to the Commissioner of Financial Regulation in a form prescribed by the commissioner:

(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 Commissioner of Financial Regulation 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 commissioner 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 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.

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 ("Oasis") for engaging in the business of making loans or advances to Maryland consumers without the proper licenses under Maryland Law. Oasis Legal Finance, LLC 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 non-recourse 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 from 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.

State Revenues: General fund revenues increase minimally from the licensing fees paid by civil litigation funding companies. It is unclear how many companies will become licensed in Maryland as a result of the bill. However, the American Legal Finance Association, a trade association comprised of civil litigation funding companies, has 21 members. The bill does not specify a licensing fee. However, consumer lenders currently pay a license fee of \$1,700 per office.

State Expenditures: General fund expenditures increase by \$59,254 in fiscal 2011, which accounts for the bill’s October 1, 2010 effective date. This estimate reflects the cost of hiring one financial examiner to handle license processing and complaints, examine and investigate civil litigation funding companies and assist with the development of regulations and preparation of the annual report.

Given the complexity of investigations handled by the enforcement unit, the current workload of the office, and because the bill requires the Office of the Commissioner of Financial Regulation to license companies that do not squarely fit into any category of business currently licensed by the office, the office will need to hire additional personnel. Also, since the bill does not require a civil litigation funding company to have a physical presence in the State, additional travel expenses may also be needed to provide oversight of these companies.

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

Salary and Fringe Benefits	\$52,961
Operating Expenses	6,293
Total FY 2011 State Expenditures	\$59,254

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

Additional Information

Prior Introductions: None.

Cross File: HB 1331 (Delegate Dumais, *et al.*) - Judiciary.

Information Source(s): Office of the Attorney General (Consumer Protection Division); Judiciary (Administrative Office of the Courts); Department of Labor, Licensing, and Regulation; BarBri: Maryland 2008; Department of Legislative Services

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