

The Latest State To Regulate 3rd-Party Funding By Statute

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In March 2016, the state of Indiana joined a handful of others — including Maine, Nebraska, Ohio and Oklahoma — that authorize and regulate the consumer third-party litigation funding industry by statute. In doing so, Indiana became the latest state to uphold consumer choice while introducing protective measures to weed out potentially predatory lending to those involved in insurance claim settlement proceedings. Scheduled to take effect on July 1, the statute also established a new distinction between the various types of legal funding. But, in doing so, it could potentially reduce the availability of capital.



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A New Definition

Indiana's legislation introduced an important new term for third-party funders, calling them "civil proceeding advance payment providers" or "CPAP providers." Likewise, with respect to third-party funding agreements, the statute uses the terms "civil proceeding advance payment transactions" or "CPAP transactions."

One important distinction is that the Indiana statute is aimed at "CPAP provider[s] provid[ing] a funded amount to a consumer claimant to use for any purpose other than prosecuting the consumer claimant's civil proceeding." Thus, the CPAP definition in the Indiana statute does not apply to those directly financing attorney fees or litigation expenses. Purposes that would fall within this definition may include funding the consumer's living expenses or medical expenses while waiting for a judgment.

Interestingly, the new law covers not only traditional civil litigation but also common alternative dispute resolution procedures, such as mediation and arbitration, as well as government administrative proceedings. It also covers related proceedings, including appeals, remands, enforcement, ancillary or parallel proceedings.

Ensuring Consumer Protection, But At What Cost?

Capping providers' rates of return is one of the hotly debated topics in regulation of the third-party funding industry. Set rate caps too low, and states may effectively eliminate funding providers' financial viability.

The Indiana statute states that a CPAP provider's annual rate of return may not exceed 36 percent of the funded amount and the servicing charge may not exceed 7 percent of the funded amount. In addition,

the CPAP provider may charge a maximum fee of \$250 for document collection and preparation if the funded amount is less than \$5,000, or \$500 for such document collection and preparation if the funded amount is greater than \$5,000. No other fees may be charged.

While setting a rate cap is an admirable attempt to protect consumers, this rate cap may actually render CPAP funding unavailable to them. For example, depending on the parameters of the particular case, a cap may not accurately reflect the risk that the CPAP provider would have to absorb, or it may make the CPAP provider's expected value of its investment commercially unviable. In such situations, CPAP providers are more likely to choose not to provide funding to those particular consumers rather than operate within the funding caps.

This may perhaps lead to a reduction in access to capital for consumer plaintiffs, rather than an expansion in access, which may contravene the stated goals of the statute. The true effect of these rate caps remains to be seen.

Nevertheless, it is important to note the statute expressly states that a CPAP transaction is not a consumer loan. While this exempts CPAP transactions from usury statutes and other consumer protection laws relating to the lending industry, the statute does not leave consumers unshielded. Instead, Indiana's statute includes a comprehensive and tailored regime for licensing and regulating CPAP providers.

Provisions of the statute include:

- The statute mandates that all CPAP providers operating in the state of Indiana, regardless of where they may be incorporated, must obtain a license from the Indiana Department of Financial Institutions by Dec. 31, 2016. CPAP providers must also be adequately capitalized as evidenced by posting a bond or irrevocable letter of credit in the amount of \$50,000 with the Department. The Indiana Department of Financial Institutions is expressly identified as the enforcement body for this statute.
- The statute details a variety of requirements relating to the format, typeface, font size, layout, content, fee disclosures, and signatures required for all CPAP contracts. This includes an attestation by the consumer's attorney, who must not receive a referral fee for connecting a client with a CPAP provider. The CPAP contract is void without the attorney's attestation, unless the attorney's representation of the consumer has been terminated.
- In addition, CPAP providers may not refer consumers to specific attorneys or law firms; instead, CPAP providers may refer unrepresented consumers only to local or state bar association referral services.

- CPAP providers, attorneys, doctors and other similar providers or their employees may neither give nor receive any referral fees, commissions or other kickbacks relating to CPAP transactions.
- The statute prohibits materially false or misleading advertisement regarding the services of CPAP providers.
- CPAP providers may not control the representation or make any decisions regarding the representation, the civil proceedings, or any settlement or resolution of the underlying dispute.
- Likewise, CPAP providers must not pay any of the costs or fees for the consumer's civil proceeding — whether before, during or after the proceeding.
- The consumer must have a right to cancel the CPAP contract for at least five business days after it has been signed, as long as the consumer returns full funded amount to the CPAP provider.
- The statute expressly includes specific language that must be included in bold within the body of the CPAP contract notifying the consumer of the right of cancelation, the nonrecourse nature of the loan, and the advisability of seeking the advice of an attorney before signing the CPAP contract.
- Privileged communications between the consumer's attorney and the CPAP provider remain protected by all evidentiary privileges, including, but not limited to, the attorney-client privilege and the work-product doctrine. Thus, no evidentiary privileges are waived by communication with the CPAP provider. This assures consumers seeking funding in the state of Indiana that they will not jeopardize their privileged information by doing so.

Since Indiana has implemented a detailed regulatory structure that is suitable for protecting consumers who choose to seek the services of a CPAP provider, classifying CPAP transactions as loans would offer no further consumer protection benefit.

Time will tell how the statute impacts the availability of CPAP provider capital, and the viability of the industry as a whole. The legislation is a positive step forward for consumer protection, but providers will

have to pay more attention to risk assessment to make it work.

Indiana's new statute is scheduled to take effect on July 1, 2016, and all CPAP providers operating in Indiana must obtain a license by Dec. 31, 2016, if applicable. The full text of the statute is available [here](#).

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