

Growth of Litigation Funding in the Wake of COVID-19

April 30, 2020 | [Latif Zaman](#)

Litigation funding - a transaction in which a funder purchases a portion of the future potential proceeds of a litigation claim from a consumer for an immediate cash advance - has proven to be an attractive alternative to a loan for consumers engaged in a lawsuit, evidenced by the rapid growth of the litigation funding industry over the past decade. While the COVID-19 pandemic has created almost unprecedented economic turmoil, it may also create an increase in both civil litigation and consumer demand for litigation funding. State regulation of consumer litigation funding is evolving rapidly and will play a key role in determining whether the industry can satisfy consumer demand for the product and continue to grow.

The economic crisis resulting from COVID-19 has elucidated certain unfortunate realities of American life. Numerous studies over the past few years have concluded that the majority of Americans effectively live paycheck to paycheck. [1] According to a 2018 Federal Reserve report, four in 10 American adults would not be able to cover an unexpected \$400 expense with cash, savings or a credit card charge that could be quickly paid off. In 2013, over half of American adults would have had trouble paying such an expense.[2] In the current economy, even more Americans likely will have difficulties coping with unexpected expenses. In March, an economist from the Federal Reserve Bank of St. Louis predicted that by the second quarter of this year, unemployment in the United States will rise to levels greater than occurred during the Great Depression.[3]

It stands to reason there will be an increased demand for short-term credit as many Americans work to cover personal expenses while getting back on their feet financially. However, it is not clear that lenders will be able to supply enough credit to meet this demand. The classic Catch-22 of lending is that the same conditions that motivate consumers to seek credit also increase the risk of default. An individual living paycheck-to-paycheck may not have a robust credit score and a recently unemployed individual will have an uncertain prospect of repayment. As a business decision, lenders will extend credit to applicants with a questionable ability to repay only if they can obtain returns commensurate with the risk of default. Furthermore, consumer lending is heavily regulated in many states and rate caps and other restrictions on terms arguably limit the viability of offering credit to many Americans.

Alternative finance products, such as litigation funding, may be an attractive option for many consumers, including those unable to obtain traditional financing. A standard litigation funding transaction is non-recourse; if there is no recovery on the case, the consumer will not be required to repay the litigation funder. The underwriting of a litigation funding transaction is based on the likelihood of success of the consumer's case and not the financial situation of the applicant. In that sense, the transaction is more egalitarian than traditional credit. Unemployment, lack of credit history, or any other factor that would compromise a consumer's ability to repay a loan would not preclude a litigation funding company from offering an advance if it found the underlying claim to have an acceptable likelihood of success.

Of course, litigation funding is only an option for consumers that have claims from which they can assign future potential proceeds. There is a school of thought that litigation is countercyclical and that the overall volume of disputes and lawsuits will generally increase in a bad economy. A study conducted in 2010 found that the number of patent claims in district courts consistently increased as the health of the economy decreased.[4] While there may not be enough research to definitively establish this correlation for other types of lawsuits, many expect the COVID-19 pandemic to directly trigger a deluge of various kinds of lawsuits. [5]

Workers in a number of different industries have already brought lawsuits against employers related to unsafe workplaces or a failure to maintain adequate protections against COVID-19. The New York State Nurses Association filed lawsuits against the New York State Department of Health and two hospitals, for failing to adequately protect the health and safety of nurses treating COVID-19 patients.[6] Walmart is currently facing a wrongful death lawsuit on behalf of an employee that died from COVID-19, alleging that the company failed to take adequate measures to protect its employees.[7] The American Federation of Government Employees filed a class action lawsuit on behalf of its members against the federal government seeking hazard pay for workers allegedly exposed to the coronavirus at the Bureau of Prisons, Department of Veterans Affairs, and Department of Agriculture. [8]

Many workers fired, laid off or furloughed in the coming months may bring claims against their former employers. A number of companies are facing lawsuits for allegedly firing employees in retaliation for criticizing workplace safety standards and policies.[9] Employee retention decisions will be heavily scrutinized, and it is likely that some workers will sue for discriminatory practices as well. Former employees filed a class action lawsuit against a technology company for alleged violations of the federal Worker Adjustment and Retraining Notification Act (the "WARN Act") [10] and its California counterpart.[11] The lawsuit alleges that the company used COVID-19 as an excuse for mass layoffs with limited advance notice. The WARN Act, and similar state statutes, generally require covered employers to provide employees with a prescribed amount of advance notice for mass layoffs or plant closings. Under the federal WARN Act, an employer that fails to provide the required notice to an employee may owe that employee back pay and benefits for each day of the violation up to a maximum of 60 days.[12]

Considering the breadth of shut down orders and travel restrictions caused by COVID-19, it is not surprising that many consumers have taken part in class action lawsuits seeking refunds for money they spent in advance for travel,[13] event tickets,[14] and subscription services such as gym memberships.[15] While many of these claims may not promise individual recoveries high enough to attract litigation funding, a number of students have taken part in class action lawsuits against colleges seeking refunds of substantial amounts of money spent on tuition and boarding costs.[16]

While the CARES Act, the 2005 Public Readiness and Emergency Preparedness Act,[17] and state laws offer healthcare providers and facilities certain protections from lawsuits related to COVID-19, they generally do not provide blanket immunity. Accordingly, we are also likely to see wrongful death and other lawsuits against healthcare providers and facilities related to the treatment of COVID-19.

As discussed above, the COVID-19 pandemic and existing economic factors may increase demand for litigation funding, setting the stage for the continued growth of the consumer litigation funding industry. However, it is important to note that thus far, the industry has flourished without express statutory regulation in most states. This seems to be changing as more legislatures enact laws governing consumer litigation funding. Critics of the industry and litigation funding trade groups generally agree that regulation is necessary. However there is great debate on the specifics of regulation.

In March, Utah Governor Herbert signed the "Maintenance Funding Practices Act"[18] (the "Act") into law, making Utah the tenth state to enact statutes expressly regulating consumer litigation funding. The Act provides consumer protections similar to those found under litigation funding statutes in Maine,[19] Nebraska,[20] Ohio,[21] Oklahoma,[22] and Vermont.[23] The Act applies to litigation funding transactions of \$500,000 or less to individuals. The Act requires subject litigation funding companies to register with the Utah Division of Consumer Protection within the Commerce Department. Among other disclosures, a litigation funding company must disclose all fees associated with funding, that the transaction is non-recourse and that the individual has a five-day right of rescission. Among other limitations, a litigation funding company may not make or attempt to influence a decision relating to the legal action that the company is funding. Notably, unlike litigation funding laws recently enacted in West Virginia and Nevada, the Act does not expressly limit fees the funder may charge in connection with the transaction.

The Alliance for Responsible Consumer Legal Funding ("ARC"), a trade group representing the litigation/legal funding industry praised the Maintenance Funding

Practices Act, stating that the law "will essentially eliminate...bad actors" in the industry.[24] The Act promotes this goal by encouraging transparency (through its extensive disclosure requirements), allowing consumers to get out of transactions within five days, imposing oversight on litigation funding companies, and prohibiting litigation funding companies from influencing the underlying claims. Legislators likely wanted to eliminate "bad actors" while not overburdening other industry participants. ARC has criticized laws regulating litigation funding in Tennessee[25] and Arkansas[26] that limit fees, arguing that these statutes limit the availability of litigation funding. As noted earlier, a traditional litigation funding transaction is non-recourse, meaning that the funder is not entitled to any recovery if the consumer claimant does not receive a settlement in connection with the underlying claim. State litigation funding laws, such as the Act, also expressly require transactions to be non-recourse. While this makes litigation funding attractive to consumers, it also creates inherent risk for a funder. For a litigation funding transaction to be economically viable, the funder must contract for potential returns high enough to justify the risk that the funder will receive no return on its investment. This may be impossible in states that impose low fee limitations on litigation funding transactions. In a report released in March, the New York City Bar Association Litigation Funding Working Group, comprised of private practitioners, prominent academics, and litigation funders, recommended against New York state imposing caps on fees in connection with litigation funding transactions, noting that "there is insufficient data to demonstrate whether New Yorkers are adversely impacted by the fact that New York does not currently have a restriction on the fees that funders can charge." [27]

Amidst great economic uncertainty precipitated by COVID-19, litigation funding may be a welcome option for many consumers looking to make ends meet. The consumer litigation funding industry may prove to be the rare countercyclical financial services sector. However, the outlook for consumer litigation funding is heavily dependent on how states decide to regulate the burgeoning industry. While clear regulation is required for the long-term viability of the consumer litigation funding industry, state lawmakers face great pressure to enact legislation that protects consumers without limiting access to funds. State laws that impose strict fee limitations on litigation funding transactions, or other restrictions that aim to overly limit the returns on litigation funding transactions, could stifle the growth of the industry and make advances unavailable to many consumers.

[1] Press Release, CareerBuilder, *Living Paycheck to Paycheck is a Way of Life for Majority of U.S. Workers, According to New CareerBuilder Survey* (Aug. 24, 2017), available at:

<http://press.careerbuilder.com/2017-08-24-Living-Paycheck-to-Paycheck-is-a-Way-of-Life-for-Majority-of-U-S-Workers-According-to-New-CareerBuilder-Survey>.

[2] Board of Governors of the Federal Reserve System, *Report on the Economic Well-Being of U.S. Households in 2017*, p. 21 (2018), available at: <https://www.federalreserve.gov/publications/files/2017-report-economic-well-being-us-households-201805.pdf>.

[3] Miguel Faria-e-Castro, *Back-of-the-Envelope Estimates of Next Quarter's Unemployment Rate*, Federal Reserve Bank of St. Louis: On the Economy Blog (Mar. 24, 2020), available at: <https://www.stlouisfed.org/on-the-economy/2020/march/back-envelope-estimates-next-quarters-unemployment-rate>.

[4] Bradley D. Riel and Paul T. Meiklejohn, *A Correlation Between the State of the U.S. Economy and Patent Litigation Activity*, Journal of the Patent and Trademark Office Society, p. 71 (Winter 2010).

[5] Richard Wolf, *Coronavirus Goes to court: After Lives and Livelihoods Come the Lawsuits*, USA Today (Apr. 3, 2020), available at: <https://www.usatoday.com/story/news/politics/2020/04/03/coronavirus-lawsuits-workers-businesses-insurers-prepare-battle/5097938002/>; see also, Bob Van Voris *et al.*, *Once Coronavirus Fades, Global Businesses Are Set to Face New Danger: A Wave of Lawsuits*, Fortune (Mar. 4, 2020), available at: <https://fortune.com/2020/03/04/coronavirus-global-businesses-wave-lawsuits/>.

[6] Press Release, Carl Ginsburg, *NYS Nurses Association Files Three Lawsuits to Protect Nurses Health and Safety* (Apr. 20, 2020), available at: <https://www.nysna.org/press/2020/nys-nurses-association-files-three-lawsuits-protect-nurses-health-and-safety#XpXTIhKIUU>.

[7] Complaint, *Evans v. Walmart, Inc.*, No. 2020L003938 (II. Cir. Ct. of Cook Cty. April 6, 2020).

[8] Complaint, *Braswell v. United States*, No. 1:20-cv-00359-VJW (Fed. Cl. Mar. 27, 2020).

[9] Complaint, *King v. Trader Joe's East, Inc.*, No. 20-CI002406 (Ky. Cir. Ct. of Jefferson Cty. Apr. 8, 2020); see also, Complaint, *Lauri Mazurkiewicz v. Northwestern Memorial Hospital*, No. 2020-L-003511 (II. Cir. Ct. of Cook Cty. March 23, 2020).

[10] 29 U.S.C. §§ 2101 *et seq.*

[11] Cal. Lab. Code §§ 1400 *et seq.*; Complaint, *Siers v. Velodyne Lidar, Inc.*, No. 5:20-cv-2290, 2020 WL 1696193 (N.D. Cal. Apr. 3, 2020).

[12] 29 U.S.C. § 2104 (a)(1)(A).

[13] *Uteley v. United Airlines Holdings, Inc.*, No. 1:20-cv-00756 (N.D. Ohio Apr. 7, 2020); *Rudolph v. United Airlines Holdings, Inc.*, No. 1:20-cv-02142 (N.D. Ill. Mar. 30, 2020).

[14] *McMillan v. StubHub Inc.*, No. 3:20-cv-00319-jdp (W.D. Wis. Apr. 2, 2020); *Rutledge v. Do LaB Inc.*, (Cal. Super. Ct. Mar. 24, 2020).

[15] *Delvecchio v. Boston Sports Clubs*, No. 20-cv-10666 (D. Mass. Apr. 5, 2020); *Labib v. 24 Hour Fitness USA*, No. 3:20-cv-02134 (N.D. Cal. Mar. 27, 2020)

[16] *Carpey v. University of Colorado, Boulder*, No. 1:20-cv-01064 (D. Colo. Apr. 15, 2020); *Dixon v. University of Miami*, No. 20-cv-1348 (D.S.C. Apr. 8, 2020); *Student A v. Liberty University, Inc.*, No. 6:20-cv-00023 (W.D. Va. Apr. 13, 2020).

[17] 42 U.S.C. 247d-6d.

[18] H.B. 312, 2020 Gen. Sess. (Utah 2020), available at: <https://le.utah.gov/~2020/bills/static/HB0312.html>.

[19] Me. Rev. Stat. Ann, tit. 9-A, §§ 12-101 *et seq.*

[20] Neb. Rev. Stat. §§ 25-3301 *et seq.*

[21] Ohio Rev. Code § 1349.55.

[22] 14A Okla. Stat. §§ 3-801 *et seq.*

[23] Vt. Stat. Ann. tit. 8, §§ 2251 *et seq.*

[24] *Id.*

[25] Tenn. Code Ann. §§ 47-16-101 *et seq.*

[26] Ark. Code Ann. § 4-57-109.

[27] N.Y.C. Bar Association Litigation Funding Working Group, *Report to the President*, (Feb. 28, 2020), available at: http://documents.nycbar.org/files/Report_to_the_President_by_Litigation_Funding_Working_Group.pdf.

Hudson Cook, LLP provides articles, webinars and other content on its website from time to time provided both by attorneys with Hudson Cook, LLP, and by other outside authors, for information purposes only. Hudson Cook, LLP does not warrant the accuracy or completeness of the content, and has no duty to correct or update information contained on its website. The views and opinions contained in the content provided on the Hudson Cook, LLP website do not constitute the views and opinion of the firm. Such content does not constitute legal advice from such authors or from Hudson Cook, LLP. For legal advice on a matter, one should seek the advice of counsel.

SUBSCRIBE TO INSIGHTS

HUDSON COOK

Hudson Cook, LLP is a national law firm representing the financial services industry in compliance, privacy, litigation, regulatory and enforcement matters.

7037 Ridge Road, Suite 300, Hanover, Maryland 21076
410.684.3200

hudsoncook.com

© Hudson Cook, LLP. All rights reserved. Privacy Policy | Legal Notice
Attorney Advertising: Prior Results Do Not Guarantee a Similar Outcome

