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- 4 Status table, Hague Conference website, available at: <https://www.hcch.net/en/instruments/conventions/status-table/?cid=137>, last accessed 7 March 2020.
- 5 Judgments Convention, article 5.
- 6 *Ibid*, articles 1 and 4.
- 7 *Ibid*, article 4(4).
- 8 *Ibid*, article 2.
- 9 Xi Jinping 'Work Together to Build the Silk Road Economic Belt and The 21st Century Maritime Silk Road', Speech by H E Xi Jinping President of the People's Republic of China At the Opening Ceremony of The Belt and Road Forum for International Cooperation, 14 May 2017, available at: http://en.cidca.gov.cn/2017-05/16/c_260434.htm, last accessed 7 March 2020.
- 10 'The First International Commercial Court of the Supreme People's Court effectively concluded the first five cases', China International Commercial Court, 30 December 2019, available at: <http://cicc.court.gov.cn/html/1/219/208/209/1547.html>, last accessed 7 March 2020.

Champerty re-emerges: an overview of recent US Circuit Court rulings on third-party funding

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While the use of third-party funding agreements has undoubtedly proliferated both globally and as to types of claims covered, champerty still stands precluding their enforcement in some jurisdictions. The issue of whether third-party lending agreements come into conflict with state champerty laws may arise in a variety of scenarios: in a direct action seeking to invalidate or enforce a lending agreement or as a procedural hurdle in determining whether a party has standing to pursue such claims. In a related vein, cash advance agreements of settlement proceeds may face similar enforcement hurdles. This article provides a summary of recent US Circuit Court decisions examining and brushing back third-party lending agreements.

In *Boling v Prospect Funding Holdings, LLC*,¹ the Court reviewed a declaratory judgment action that set aside litigation funding agreements in an action filed by borrowers against their funder. The funder provided US\$30,000 through four loan agreements to the borrowers to pursue damages for personal injuries arising from a gas explosion. When the claim was ultimately settled, the funder sought some US\$340,000 (bearing compound interest of approximately 80 per cent) from the borrowers who then filed suit in a Kentucky

district court for declaratory relief that the loan was void and unenforceable.

Notably, none of the four underlying loan agreements at issue in the borrowers' suit provided for application of Kentucky law. Two of the agreements contained New Jersey choice of law provisions, another Minnesota law and one New York law. The borrowers sued in their home state of Kentucky to set aside the agreements.

The district court made a series of orders which were the subject of review. The Kentucky district court held the agreements were governed by Kentucky law and that they violated Kentucky champerty and usury laws. As a result, the district court held the agreements void and unenforceable but granted summary judgment to the funder on its unjust enrichment and promissory estoppel claims for the loan proceeds plus loan fees (approximately US\$34,000).

First, the district court determined that the suit was properly filed in Kentucky pursuant to the first agreement which afforded either party the right to select a competent forum. The district court found the varying law provisions in the agreements entitled it to decline enforcing any one of them in favour of principles of judicial economy. Notably, despite the presence of mandatory forum selection clauses, the Circuit Court held that

the lender's failure to seek transfer before the district court had essentially waived application of the clauses. The Circuit Court also affirmed the decision to exercise jurisdiction over all of the agreements, thereby denying the lenders' motion to dismiss for forum non conveniens, again because the arguments had not been properly presented to the district court.

Of course, the key holding by the district court was its decision to apply Kentucky law. The district court applied Kentucky choice of law analysis and held Kentucky law applied despite the varying choice of law provisions contained in the agreements, none of which called for Kentucky law. The district court relied on Kentucky's preference of its own law and application of the most-significant relationship test to determine the applicable law. In this case, the injury occurred in Kentucky, the borrowers resided in Kentucky, and while negotiations related to the agreements occurred in several states, including Kentucky, the agreements were executed in Kentucky. The district court also emphasised that each of the other states had minimal connections to the dispute. Moreover, Kentucky had a strong interest in applying its statutes prohibiting champerty and usury. As a result, the Circuit Court affirmed the determination that Kentucky had the most significant relationship to the underlying dispute and applied to all four agreements.

Review of the district court's finding that the agreements were void began with the principle that federal courts sitting in diversity must apply the state law consistent with the determination of the state's highest court. Although Kentucky courts had not addressed the legality of litigation funding agreements, Kentucky's champerty statute provides:

'Any contract, agreement or conveyance made in consideration of services to be rendered in the prosecution or defense, or aiding in the prosecution or defense, in or out of court, of any suit, by any person not a party on record in the suit, whereby the thing sued for or in controversy or any part thereof, is to be taken, paid or received for such services or assistance, is void.'²

The district court determined Kentucky courts would likely void the agreements as champertous. The Third Circuit agreed based primarily on the plain language of the statute and the fact that the 'Agreements effectively represented an advance on Boling's recovery, contingent on Boling recovering funds'

and likely 'constitute "assistance" within the meaning of the statute.'³ Another key factor was the degree of control over the litigation the funder could exercise, including a mandatory pay-out in the event the borrowers changed legal counsel without the funder's consent. The Court found such a provision in violation of Kentucky's strong policy favouring settlement of disputes. As such, the agreements were held to be void as in violation of Kentucky's champerty statute and public policy as well as its usury statute.

Dissatisfied with that result, the funder then filed suit in a New Jersey district court against the borrower's counsel on his acknowledgements to the agreements and obligation to pay the funder from the settlement proceeds before the borrowers. In *Prospect Funding Holdings, LLC v Breen*,⁴ the Third Circuit affirmed the dismissal of the funder's case for breach of contract, conversion and promissory estoppel arising from failure to remit the proceeds pursuant to the funding arrangements.

The district court dismissed the case based on issue preclusion arising from the Kentucky district court's prior determination that the loan violated Kentucky champerty and usury laws. The district court rejected the funder's contention that counsel's acknowledgement was separate from the underlying funding agreements and dismissed the action as precluded by the Kentucky district court's ruling that the underlying loan agreements were void and unenforceable. On appeal, the Circuit Court affirmed the dismissal based on the Kentucky court's decision that the agreements were void and enforceable.

In another case, the Third Circuit applied Pennsylvania law to the issue of whether an assignment of a claim was champertous. In *Riffin v Consolidated Rail Corp*,⁵ the Court summarised the issue as follows:

'Under Pennsylvania's champerty doctrine, "an arrangement offends public policy against champerty and is illegal if it provides for the institution of litigation by and at the expense of a person who, but for that agreement, has no interest in it, with the understanding that his reward is to be a share of whatever proceeds the litigation may yield." "[T]he common law doctrine of champerty remains a viable defense in Pennsylvania," and, "if an assignment is champertous, it is invalid." "An assignment is champertous when the party involved: (1) has no legitimate interest in the suit, but for the



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agreement; (2) expends his own money in prosecuting the suit; and (3) is entitled by the bargain to share in the proceeds of the suit.” (internal citations omitted).⁶

The Court easily disposed of Riffin’s claim as champertous under Pennsylvania law because he had no interest in the subject matter of the underlying dispute (involving property rights from the sale of historic rail to developers); expended his own funds to bring the claim while the real party in interest expended no funds; and was to obtain a percentage of the ultimate recovery.

Riffin argued that New Jersey law, which did not prohibit champerty, applied to his claims. The Court undertook a choice of law analysis and ultimately determined that Pennsylvania had a greater interest in application of its laws because champerty offends its public policy. Reasoning that New Jersey had little interest in enforcement of such agreements, the Court held Pennsylvania law applied thereby rendering the assignment champertous and finding the Plaintiff lacked standing to pursue his claim.

The related issue of cash advances on settlement proceeds was also addressed by the Third District, this time applying New York law. *In Re: National Football League Players’ Concussion Injury Litigation*,⁷ involved the enforceability of cash advance agreements entered by class members. There, a Pennsylvania district court presided over a class action suit brought by former professional football players against the NFL for concussion-related injuries. The settlement agreement subsequently approved by the court contained an anti-assignment provision of the underlying claims rendering them void and unenforceable. Several players subsequently entered into cash advance agreements with various lenders under varying terms to obtain funds while awaiting the class pay-out. The district court retained jurisdiction to enforce the settlement and invalidated the cash advance agreements through a series of orders aimed at protecting the class members from predatory funders.

On appeal, the Third Circuit affirmed that portion of the district court’s order that voided any lender’s right to seek funds directly from the class settlement fund as contrary to the plain language of the district court’s anti-assignment provision contained in the settlement agreement and adopted

by the court. However, the Court reversed the district court’s order that purported to set aside the cash advance agreements in their entirety reasoning that the district court lacked jurisdiction to do so after disbursement of the funds.

‘...the Court had the option of invalidating only the assignment portions of the agreements containing true assignments and directing the Claims Administrator not to recognise any true assignments, without voiding the agreements in their entirety. Some of the agreements contained severance clauses or alternative loan agreements, and there is a dispute as to whether the purported assignments in the funding agreements were true assignments at all. Accordingly, there are portions of the cash advance agreements that may be enforceable even after any true assignments are voided. Of course, once the funds are disbursed to the players, the District Court’s power over the funds, and any contracts affecting the funds, is at an end.’⁸

As a result, the Court confirmed that the enforceability of the cash advance agreements that did not contain assignments would require independent challenge and review in subsequent cases.

In each of these Circuit Court decisions over the past year or so, lending agreements were analysed and denied enforcement. Although the practice of third-party funding continues to grow across jurisdictions and over a variety of claims, these cases serve as a reminder that champerty precludes such funding arrangements in certain jurisdictions. Further, as demonstrated in *Boling*, the attempt to draft around application of champerty laws by selecting more favourable choice of law provisions is not always successful. While these cases appear to be in the minority, it is important to recognise that in some US jurisdictions, champerty remains viable.

Notes

- 1 771 Fed Appx 562 (6th Cir 2019).
- 2 Ky Rev Stat section 372.060.
- 3 Ky Rev Stat section 372.060, at 519.
- 4 757 Fed Appx130 (3d Cir. 2018), the opinion was issued in December 2018 while the appeal from the earlier decision on which it was based was issued in April 2019.
- 5 783 Fed Appx 246 (3d Cir 2019).
- 6 Ky Rev Stat section 372.060, at 249.
- 7 923 F 3d 96 (3d Cir 2019).
- 8 Ky Rev Stat section 372.060, at 111.