

In Permitting New York AG Case Alleging Consumer Law Violations by Litigation Financiers to Proceed, Court Comments on Distinctions in Litigation Funding Arrangements

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Consumer Financial Protection Bureau and The People of the State of New York v. RD Legal Funding, LLC, et al., Case No. 17-cv-890 (LAP) (S.D.N.Y. June 21, 2018)

Brief Summary

After concluding as a matter of law that the settlement agreements did not permit assignment of a party's right to recover from the settlement fund, the U.S. District Court for the Southern District of New York permitted causes of action against two legal finance companies and their founder and owner under the Consumer Financial Protection Act (CFPA) and under New York's consumer protection and usury statutes to proceed. The court determined that, if the rights were not assignable, the legal financiers could not obtain an interest in the settlement proceeds pursuant to a "sales" transaction. Consequently, the cash advances were loans and subject to consumer finance protection rules and regulations.[\[1\]](#)

Case Summary

The case involved an action by the Consumer Financial Protection Bureau (CFPB) and the New York Attorney General (NYAG, and collectively with CFPB, the "Government") against two litigation finance companies – RD Legal Funding, LLC and RD Legal Funding Partners, LP (the "RD Entities") and their founder and owner, Roni Dersovitz (collectively, "Defendants"). The RD Entities offered cash advances to "consumers" waiting for payouts from settlement agreements or judgments entered in their favor.

The Government alleged that Defendants misled consumers into entering into cash advance agreements by representing that the transactions were valid and enforceable sales when in reality, they were usurious loans void under state law. The Government asserted that Defendants violated various provisions of the CFPA. The NYAG further alleged several causes of action under New York law, including that: the litigation finance agreements at issue constituted unlawful assignments of individual claims to recover for personal injuries under New York's General Obligations Law § 13-101; and violation of New York's deceptive trade practices law (General Business Law § 349).

Defendants moved to dismiss the action on three principal grounds: (i) that the CFPB was unconstitutionally structured and lacked authority to bring the claims under the CFPA; (ii) that the court lacked federal jurisdiction because the RD Entities were not "covered persons" under the CFPA; and (iii) that the complaint failed to state a claim pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure. While the court agreed that CFPB was unconstitutional and could not be a party to the action, it concluded that federal jurisdiction existed under the CFPA and that each of the alleged federal and state claims stated a cause of action.

The Facts

At issue in the action were two specific groups of "Consumers" – (i) class members in the NFL concussion litigation class action ("NFL Class Members"); and (ii) individuals who qualified for compensation under the September 11 Victim Compensation Fund of 2001 ("VCF") ("Eligible Claimants"). The NFL Class Members had entered into a settlement agreement approved by the Eastern District of Pennsylvania in February 2015. The Eligible Claimants are individuals who had received award letters indicating they were entitled to an award from the VCF.

As alleged in the complaint, after a Consumer received a final approval and notice of the award amount to which he or she was entitled, the RD Entities offered to take a security interest in the settlement award or a portion thereof. In exchange, the RD Entities paid a lump sum cash payment to the Consumer that represented a portion of the total award to which he or she was entitled. In return, the Consumer agreed to pay an additional amount to the RD Entities when the settlement was finally paid out to the Consumer; any amount over the repayment amount was to be kept by the Consumer.

Each transaction was set forth in a "Purchase Agreement" that contained a "no recourse" provision that relieved the Consumer of any liability to pay the RD Entities in the event the settlement award was never paid to the Consumer. With respect to the NFL Class Members and the Eligible Claimants, the RD Entities entered into two types of Purchase Agreements: one where the repayment amount to the RD Entities was the same regardless of when the settlement was paid, and one where the longer it took for the settlement to be paid, the more the Consumer owed to the RD Entities.

Federal Jurisdiction

The CFPA

A “covered person” under the CFPA is “any person who engages in offering or providing a consumer financial product or service.” Defendants argued that no federal jurisdiction existed because they were not “covered person[s] or service provider[s]” who are engaged in “unfair, deceptive, or abusive act[s] or practice[s]” under the CFPA. They further argued that they were not providing a consumer financial product because the assignments by the Consumers were legally permissible and therefore were true sales of the Consumers’ interest with no repayment obligation if the RD Entities were unable to collect.

The Government countered that the RD Entities were “covered persons” because they extended “credit” and serviced loans. It further contended that (i) the assignments were void; (ii) the Purchase Agreements did not constitute valid sales of the Consumers’ interests; and (iii) the Consumers were encumbered with an obligation to repay the RD Entities.

The Assignments Were Void

The court began its analysis by determining that the assignments contained in the Purchase Agreements were void. With respect to the NFL Class Members, the Eastern District of Pennsylvania had already concluded that the NFL settlement agreement contained an anti-assignment provision, rendering the assignments in the Purchase Agreements of the NFL Class Members void; the court adopted the Eastern District’s opinion.

The court then concluded that the assignments of the Eligible Claimants’ compensation awards were invalidated by 31 U.S.C. § 3727 (“Anti-Assignment Act”). The Anti-Assignment Act imposes restrictions on the assignment of claims against the United States Government. While Defendants argued that the Act only barred assignment of a substantive claim against the United States—not the assignment of settlement proceeds—the court disagreed, finding that the award of settlement proceeds in the Eligible Claimants’ award letters was a “right to demand money from the United States.” Assignments of such awards were, therefore, in violation of the Anti-Assignment Act.

Defendants Were “Covered Persons”

Defendants then argued that, if the assignments were void, the Purchase Agreements were not enforceable, and therefore, they should not incur any penalty under the CFPA. The court, however, determined that the assignments were only void against third party obligors—here the VCF Claims Administrator and the NFL Settlement Fund—but gave rise to a debtor-creditor relationship between the RD Entities and the Consumers.

Because the assignments were void, there was no transfer of ownership rights that would support the argument that the Purchase Agreements were “sales” of the Consumers’ interest. Rather, the RD Entities only obtained a potential equitable lien on the Consumers’ future settlement award, thereby establishing a debtor-creditor relationship, separate and apart from the void assignments. Accordingly, having pled that Defendants “extended credit,” and the Consumers “incurred debt” under the Purchase Agreements, the Government had adequately pled that the RD Entities were “covered persons” under the CFPA.

Litigation Funding Distinguished

The court distinguished pre-settlement litigation funding from the Purchase Agreements at issue. As set forth in the American Legal Finance Association's ("ALFA") amicus curiae brief, pre-settlement legal funding agreements are entered into before the claim is resolved, and the ALFA member's right to repayment is contingent upon the consumer's ultimate success on his or her claim. The Purchase Agreements with the RD Entities presented no such risk of loss because, as a prerequisite, the RD Entities required the Consumers to have a settlement award letter stating the amount to which they are entitled from their respective settlement fund.

The Complaint Stated Causes of Action Under Federal and State Law

CFPA

The complaint alleged five causes of action under the CFPB, and five under New York law. Defendants responded to the CFPB claims by arguing that they were based upon conclusory allegations that the Purchase Agreements were loans, not sales. Having already found that "the Purchase Agreements were void and functioned plausibly as extensions of credit, the [c]ourt reject[ed] this defense and [found] that Defendants engaged in deceptive acts or practices in violation of CFPB."

Specifically, the court determined that the complaint adequately pled that Defendants (i) deceptively marketed the Purchase Agreements as sales when they should have been characterized as loans; (ii) engaged in deceptive advertising and misleading statements, including an ambiguous statement about their ability to expedite payment of the settlement funds; (iii) violated state law by collecting on void or usurious contracts; and (iv) engaged in "abusive" conduct under the CFPB. For each violation, the court further concluded that the complaint adequately pled that Dersovitz had provided "substantial assistance" to the RD Entities.

New York State Law Claims

While the CFPB was determined to lack authority to bring the CFPB claims, the court recognized the independent authority of the NYAG to bring those claims, and therefore, federal jurisdiction existed regardless of the constitutionality of the CFPB. The court further exercised its supplemental jurisdiction over the state law claims.

Civil and Criminal Usury

Defendants' sole response to the usury claims under New York Banking Law § 14-a and Penal Law §§ 190.40 and 190.42, was that the Purchase Agreements were sales, not loans. Having already concluded that the transactions were loans, the court determined that the NYAG had adequately pled that at least some of the Purchase Agreements functioned as loans with usurious rates of interest.

General Obligations Law § 13-101

General Obligations Law § 13-101 prohibits the sale or assignment of claims or demands to recover for personal injuries. Defendants argued that there was no violation of the statute because the transactions transferred the rights to proceeds for claims for personal injury, not the personal injury claims themselves. The court disagreed, concluding that the complaint adequately alleged facts demonstrating that the Purchase Agreements transferred

a “claim or demand” to “damages for personal injury” because the agreements purported to transfer to the RD Entities the right to demand payment directly from the settlement fund administrator.

General Business Law §§ 349 and 350

To state a claim for deceptive practices under section 349, the complaint must allege that the act, practice or advertisement was (i) consumer oriented and (ii) misleading in a material respect, and that the complaining party was injured as a result; the standard for recovery for a cause of action for false advertising under section 350 “is otherwise identical to section 349.” The court again concluded that the statutory claims had been adequately pled where it was alleged that (i) Defendants made the same representations to all Consumer targets; (ii) it was materially misleading to advertise the transactions as “sales” rather than loans, and to characterize the Purchase Agreements as “sales” of the ownership rights where the Consumers were not entitled to assign their rights in the settlement proceeds; (iii) the Purchase Agreements may have charged usurious rates of interest; and (iv) it was likely that a reasonable consumer would have been misled into believing that the transactions were true sales and that Defendants had the ability to expedite payment.

Executive Law § 63(12): Fraud

Executive Law § 63(12) “empowers the Attorney General to seek injunctive and other relief whenever a person or business engages in repeated . . . or . . . persistent fraud or illegality.” The court concluded that because the elements of section 63(12) “are entirely encompassed by the elements of deceptive acts or practices under the CFPB or General Business Law § 349, that the Government has already pled adequately, the [c]omplaint contains sufficient allegations to state a claim under” section 63(12).

Significance of Decision

The decision demonstrates that courts will look behind the wording of an agreement to determine the true nature of a transaction and distinguish litigation funding agreements where there is risk and agreements where the recovery is certain.

[1] The court held, in contrast to an *en banc* holding of the U.S. Court of Appeals for the District of Columbia, *PHH Corporation v. Consumer Financial Protection Bureau*, 881 F.3d 75 (D.C. Cir. 2018), that the Consumer Financial Protection Bureau is unconstitutionally structured.