A CALL FOR REGULATING THIRD-PARTY DIVORCE LITIGATION FUNDING

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I. INTRODUCTION

Loan sharks may have a new opportunity lending legally thanks to an unregulated lending market with available interest rates of up to 480% APR¹: divorce litigation funding. The practice is already in use by a growing number of businesses in the United States, which fund the costs of a divorce and living expenses while the divorce is pending.² These lending companies provide non-recourse advances to individuals involved in a divorce, in exchange for a fee that is based on a percentage of the marital settlement.³ The borrower is required to pay back from the settlement the amount borrowed plus the fee. With potential annual percentage rates so high, the growth in this market is not surprising.

Investing in divorce litigation is a subset of a much broader and emerging category of investments: third-party litigation finance. The majority of third-party litigation financiers focus on commercial suits, lending upwards of $15,000,000 per case.⁴ Hedge funds, boutique lenders, and even banks have nearly $1 billion invested in American litigation.⁵ It can prove to be extremely profitable for the lenders—getting a favorable outcome means an enormous return in a relatively short turn-around.⁶ On the other hand, if the client loses the case, the lender loses the entire investment without any recourse against the borrower.⁷

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¹ This rate may be uncommon, but it is calculated using the pricing structure advertised by one of the divorce funders based on a loan for one month. Divorce Settlement Loans, GET LAWSUIT LOAN, http://www.get-lawsuit-loan.com/divorce-settlement-loan.html (last visited Mar. 17, 2011).


³ See id.


⁶ See Divorce Settlement Loans, supra note 1.

While many scholars have evaluated the effects of third-party litigation funding in general, none have focused their analysis specifically on third-party divorce funding. Divorce funding raises unique issues because of underlying policy concerns that are not implicated with commercial claims. Specifically, the public policy to maintain the strength and stability of marriage compels careful consideration before allowing divorce funding to become a nation-wide, common practice.

Section II provides a brief overview of the current usage of third-party litigation funding with a focus specifically on divorce funding. Additionally, Section II examines some of the laws governing divorce funding and how divorce funding implicates policy concerns not present with other areas of litigation funding.

Section III acknowledges certain benefits of divorce funding and analyzes the societal and personal costs of its use. Due to the lack of laws regulating the practice, investors are granted almost complete free-reign regarding the contractual terms of the advance. Section III also explores the negative effects that are likely to occur with the continuation of unregulated divorce funding, including an increase in the quantity and cost of divorce proceedings, a heavier burden on society as a result of the increased number of divorces, and lenders influencing the litigation inappropriately and encouraging more spending than necessary.

Finally, Section IV proposes a two-front solution, focusing on a call to action by state legislatures to regulate divorce funding to prevent harmful effects that will almost undoubtedly arise if left unchecked.

II. A Snapshot of Third-Party Litigation Funding

A. In General

Third-party litigation funding involves lenders providing funds for a variety of expenses, most commonly by purchasing an interest in the outcome of the case. Lenders offer money upfront to cover litigation costs such as attorney fees, discovery, expert witnesses, and court costs. The practice carries a variety of names, such as litigation funding, pre-settlement funding, lawsuit loans, or some variation. Whatever its moniker, the premise generally involves a scheme whereby investors pay some or all of the litigation costs upfront in exchange for either a fee or a percentage of the winnings or settlement.

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9 Lyon, supra note 4, at 574.

10 See id. at 573–74.

11 Id. at 574.
Third-party litigation funding has been in use for quite some time in Europe and Australia but is just starting to see greater utilization in the United States. In its earliest form in the United States, litigation funding generally took the form of pre-settlement loans or syndicated lawsuits for personal injury plaintiffs and class action lawsuits. The expenses for these types of suits made it necessary to seek outside funding to cover living expenses while the suit was pending. However, there is a growing trend of lenders expanding into other types of litigation, with commercial litigation taking on the bulk of the litigation funding market.

Lending companies are drawn to investing in litigation because of the diversification it provides. Investments in litigation are not tied to the market risks to which stocks, bonds, and other more common investment vehicles are so heavily subject. Each case is shielded from market pressures, being evaluated based on the type of case, the amount in controversy, the amount of funding needed, the complexity of the case, the likelihood of settlement, and any issues unique to the case. The return depends more heavily on a case’s facts and circumstances than on the market. This has led to many private litigation-investment companies, and even a number of publicly traded investment funds.

B. Divorce Litigation Funding

As part of the growing trend of litigation funding, some companies have established a niche in litigation funding for divorce cases. This is not surprising because the current regulations create the perfect market opportunity—getting a divorce is increasingly expensive and couples are prohibited from entering contingent fee arrangements with their attorney to defer the cost.

Typically, each spouse pays the costs associated with the divorce with each bearing their own expenses. Retirement funds, credit cards, and home equity loans are not uncommon sources to which couples turn to pay for the expenses.
associated with a divorce.\textsuperscript{21} Though a number of factors influence the final figure, the typical divorce costs approximately $15,000.\textsuperscript{22} This estimate includes attorney fees, relocation expenses, and other out-of-pocket expenses.\textsuperscript{23} It does not, however, take into account other costs, such as the loss of income or the emotional expenditures that always accompany the process.\textsuperscript{24} Other factors, such as whether the divorce is contested, the hourly rates of the attorneys, whether the parties battle over the custody of the children, the amount and complexity of the marital debts and assets, and the legal strategy taken by the attorneys, affect the overall price.\textsuperscript{25} A contested divorce increases the cost tremendously and averages between $49,000 to $188,000.\textsuperscript{26}

This staggering price tag can make divorce financially unfeasible for many couples. In fact, a significant number of couples postpone divorce during a difficult economy because they cannot afford it.\textsuperscript{27} The financial difficulty in securing a divorce is compounded if one spouse prevents the other from gaining access to the finances. While a court may issue an order for one spouse to pay the other temporary spousal support during the pendency of the proceeding (including enough money to cover the legal expenses),\textsuperscript{28} it is strictly within the court’s discretion to do so.\textsuperscript{29} Likewise, it may not be obtainable or might be issued only after each spouse has already spent thousands of dollars.\textsuperscript{30}

Enter divorce funding. The typical divorce-funding scenario as described by many of the divorce lenders involves one spouse with greater access to or control of the money.\textsuperscript{31} The other spouse stays at home and has limited access to the

\textsuperscript{23}Id.
\textsuperscript{24}See id.
\textsuperscript{26}Launching a Divorce War, CONSUMER REPORTS (Feb. 2008), http://www.consumerreports.org/cro/money/personal-investing/money-mistakes-2-08/launching-a-divorce-war/money-mistakes-launching-a-divorce-war.htm.
\textsuperscript{27}See Donna St. George, Estranged Spouses Increasingly Waiting Out Downturn to Divorce, WASHINGTON POST (Mar. 22, 2010), http://www.washingtonpost.com/wp-dyn/content/article/2010/03/21/AR2010032103139.html (noting that approximately 20,000 fewer divorces were filed during the height of the recession of 2008). In a study of divorced couples, “the primary reason for delay was financial, and once they could see a way to survive financially, they were on their way out of the marriage.” David Knox & Ugo Corte, Work It Out/See a Counselor: Advice from Spouses in the Separation Process, 48 J. Divorce & Remarriage 79, 81 (2007).
\textsuperscript{28}24A AM. JUR. 2d Divorce and Separation § 587 (2010).
\textsuperscript{29}Id. § 604 (2011). See also 27B C.J.S. Divorce § 547 (2011).
\textsuperscript{30}See 24A AM. JUR. 2d Divorce and Separation § 604 (2011).
\textsuperscript{31}See Appelbaum, supra note 2.
financial matters of the household. Even in scenarios where both spouses are working, the increase in expenses associated with the divorce, coupled with limited access to the income from the other spouse, may nevertheless make divorce financially unreachable. During the divorce, there is an extra housing payment, extra utilities, and extra groceries paid for from the same pre-divorce income.

Regardless of a given couple’s financial situation, divorce funding may seem like the solution to cover the myriad of expenses during the divorce, and not just those directly related to the litigation. Obviously the client can use the money to cover court fees, attorney fees, and other direct litigation expenses. Beyond legal expenses, the client may use the money to cover the cost of living such as rent, groceries, daycare, car payments, insurance, and other bills. Additionally, the borrower may use the funds for expenses often unheard of in the typical divorce case, such as expert asset investigations to uncover hidden finances, forensic accounting investigations, and fraud investigations.

One recent case provides insight into the specific contractual terms of a lawsuit advance. The lending company advanced $3,000 to pay legal fees for the plaintiff. The contract specified that if the plaintiff paid back the lender prior to three months, the borrower had to repay $4,200, representing the amount of the advance plus a $1,200 fee. If not paid within three months, the borrower had to pay an additional 7.8% of the advance ($234) each month thereafter, up to a maximum of $9,350, or 3.25 times the amount of the advance.

Even though this particular advance was not used to fund a divorce, it provides very useful information into the rates charged by lenders. Most lenders provide specific terms only after an analysis that is very case-dependent and will not reveal the terms to non-clients.

Typically, however, as advertised by most litigation lenders, the funds are only due if the client wins or settles. In the case of divorce funding, the borrower only repays the amount from the settlement. This can be deceptive, because it is

32 See id.
33 St. George, supra note 27.
35 See id.
39 Id. at 770.
40 Id.
41 Id. at 770–71.
unclear whether reconciliation counts as a settlement. Even if repayment is not required if the couple reconciles, the majority of couples do not reconcile after filing for divorce. 43 Couples that separate are equally unlikely to reconcile. For couples that separate for eighteen months, there is nearly a 70% likelihood that the relationship will end in divorce. 44 Almost all divorce cases will end in a settlement where the default split is 50/50. Divorce funding, as a result, does not involve the same level of risk as commercial litigation funding, because there is almost no chance that the borrower will not have to repay the money.

Litigation funding in general involves an objective assessment of each case, deeply analyzing the merits of the case. The lenders then fund the cases they believe have the greatest chance of success. This is not the case in divorce funding. The only determining factors, in terms of merit, in the decision for divorce lending are (1) the amount of marital assets not encumbered by a pre-nuptial agreement, and, for some lenders, (2) the expenses stemming from the divorce litigation. 45 No assessment is made into the merits of the divorce. The questions are: “Do you have enough money coming to you that we can take a part of”? or, “Are your expenses big enough so that you do not waste our time on small transactions”? Neither of these considerations allows an objective analysis of the legal claims, but may provide an objective assessment of the marital assets.

Due to the divorce funding industry’s infancy, most lenders appear to be trying to stay on the safer side of ethical boundaries. 46 Specifically, some lenders purposefully limit the contact and interaction with the borrower, and require that an attorney represent the borrower. 47 Some lenders also purposefully do not take an active part in the litigation. Others are on the opposite end of the spectrum, even marketing their ability and expertise to take over and direct a client’s case. 48


46 However, because it is unclear whether laws prohibiting champerty and maintenance are still applicable, it is not unrealistic that companies looking to make a profit will overstep the blurry ethical boundaries.

47 *Get Lawsuit Loan, supra note 34.*

48 *John Beisner et al., U.S. Chamber Inst. for Legal Reform, Selling Lawsuits, Buying Trouble: Third-Party Litigation Funding in the United States 7–8 (2009).*
C. Current Regulations Relating to Divorce Funding

In terms of lawyers funding divorce cases, lawyers are prohibited from entering contingency fee arrangements in securing a divorce. The Model Rules of Professional Conduct base this prohibition on public policy, recognizing that the attorney should not have a financial incentive to encourage securing a divorce. It is easy to imagine the undesirable effects that allowing such a practice would have on families, society, and the legal profession.

Some states also regulate an attorney’s ability to refer clients to divorce lenders. While some states strictly forbid attorneys from making such referrals, other states allow it so long as certain disclosures are made and specific language is included in the agreement.

Lenders, on the other hand, are not subject to the same contingency fee restrictions as attorneys, and they escape most regulations relating to lending. For instance, divorce funding is not subject to most states’ usury laws that put a cap on interest rates because the practice is not technically or legally considered lending. One company recognizes this fact and observes that the industry in general does not follow the Federal Truth in Lending laws or state usury laws. Loans that are structured as loans would be subject to the state’s usury laws. Divorce funding, however, is not a loan in most instances. More frequently, the “lender” purchases an interest in the future settlement of the divorce by providing an advance, thereby evading being subject to the states’ usury laws. For the same reason, federal regulations relating to lending, such as the Truth in Lending laws, are inapplicable to divorce funding situations.

Instead, in the vast majority of the states, the only regulations to which lenders are subject are laws prohibiting maintenance and champerty. These laws are unclear and extremely dated, originating during the medieval times.

49 Model Rules of Prof’l Conduct R. 1.5(d)(1) (2010) (“a lawyer shall not enter into an arrangement for, charge, or collect . . . any fee in a domestic relations matter, the payment or amount of which is contingent upon the securing of a divorce or upon the amount of alimony or support, or property settlement in lieu thereof”).

50 Beisner, supra note 48, at 3–4.

51 North Carolina is one state, and possibly the only state, where it is clear that these types of advances are subject to the state’s usury laws, and as a result, many lenders do not fund cases in that state. See Odell v. Legal Bucks, LLC, 665 S.E.2d 767, 770–71 (N.C. Ct. App. 2008).


54 Lyon, supra note 4, at 575.
claim,” and champerty “is maintenance by those seeking to profit.” Laws prohibiting maintenance and champerty arose prior to our modern rules of civil procedure and out of the fear that third parties would purposefully stir up strife in order to profit. The continuing applicability and validity of these laws is ambiguous, especially because the modern rules of civil procedure addressed the concerns that led to their institution.

On the other hand, some states have openly allowed litigation funding. For instance, the Ohio legislature passed a law specifically allowing litigation funding, at the same time reversing an Ohio Supreme Court decision outlawing the practice. Maine also allows litigation funding, but requires funding companies to register with the state and mandates that certain provisions are to be included in all contracts. It is under this ambiguous patchwork of laws that divorce funding operates.

III. ANALYSIS

A. Personal Benefits of Divorce Litigation Funding

Divorce funding offers certain benefits. First, divorce funding may be the only way a spouse feels able to get out of an abusive, controlling, or harmful marriage. As noted above, divorce can be extremely expensive, and divorce lawyers are precluded from accepting a contingency fee from the settlement. It is not difficult to imagine a situation where the breadwinning spouse has moved on to another love interest, cut off the other spouse from all finances, and essentially trapped the other spouse in a loveless and harmful relationship. Thus, one of the only ways this spouse can secure the money needed to obtain a divorce is through divorce funding. Divorce funding can provide this spouse with a way out.

Second, divorce funding may give the parties sufficient time to reach an equitable settlement. Often, the spouse with greater access to money puts pressure on the other to accept a less-than-fair settlement. This is accomplished by tactics aimed at delaying the proceeding or depleting the other’s finances, such as draining joint bank accounts, filing unneeded motions, repeatedly changing attorneys or requesting extensions, or failing to appear for hearings. The money available through divorce funding will cover living expenses and fees associated

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56 See Lyon, supra note 4, at 580–87.
57 Id. at 585.
58 BEISNER ET AL., supra note 48, at 4.
59 Id.
with the divorce. This can give the borrowing spouse sufficient resources, even without access to the finances of the other spouse, to cover the necessary expenses while the divorce is pending. As a result, divorce funding can level the playing field.

Third, because of the “leveled playing field” divorce funding may remove a major incentive to drag out the process. When both parties have access to the financial resources needed to respond to the other’s actions in court, neither party will be able to draw out the litigation in hopes to deplete the opposing party’s financial resources. Both spouses will have financial incentives to reach a settlement quickly.

As a result of these benefits, supporters for divorce funding argue that the practice allows greater access to justice. 62 The funding provides those with legitimate need for divorce an opportunity to pursue the divorce when it would have otherwise been financially out of reach.

B. Personal Costs of Divorce Funding

Although divorce funding brings about certain benefits, the costs are also significant. First, funding may not be necessary in most cases because temporary spousal support is available, requiring the financially stronger spouse to pay living expenses and costs of the divorce for the other spouse for the duration of proceedings. 63 Additionally, almost all divorce funders advertise that their money is very expensive, and some even encourage seeking other methods of funding first. 64 Therefore, this high-cost funding may not be the best or only alternative for the spouse who feels financially trapped in a marriage because they cannot afford a divorce.

Second, the additional money and the accompanying extra time to reach an equitable settlement may turn out to be financially detrimental. The advance is only a benefit to the extent that the marginal increase in the settlement, less any added expenses, exceeds the cost of the advance. To illustrate, suppose one spouse secures an advance of $50,000 to cover fees and living expenses, and agrees to pay back the $50,000 and a $10,000 fee for the advance. As a result of the added funds, the borrowing spouse is able to use the time to negotiate an increase in the settlement offer of $50,000. However, because of the added time used to obtain the increased settlement, the borrowing spouse incurred additional expenses of $50,000. The settlement increased by $50,000, but so did the expenses. The borrower has not benefited financially from the advance, but rather, has lost $10,000 by using funding and not taking the lower settlement offer.

And that may be only the beginning of the continuing financial difficulty for the spouse borrowing the funds. The manner of repayment once a settlement is reached, tellingly, is undisclosed by any of the lenders. Rather, all lenders flaunt

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63 24A AM. JUR. 2D Divorce and Separation § 587 (2010).
64 See, e.g., Divorce Settlement Loans, supra note 60.
that no payment is required until the parties reach a settlement. Reaching a settlement though is a far cry from a guarantee that the borrower will be able to enforce the settlement and receive payment from the other spouse, or have enough liquid assets to cover the repayment to the lender. Suppose, for instance, that the borrowing spouse receives as their portion of the settlement the house, a car, and a monthly cash payment for spousal and child support just large enough to cover living expenses. The borrowing spouse will likely have to sell the home or the vehicle to repay the advance. The spouse should not have to sell their home or car to pay the high fees of a divorce financier. The spouse who turned to divorce funding because they could not afford the cost of a divorce will be equally unable to pay for the divorce using divorce funding even after a settlement is reached.

Third, instead of encouraging couples to reach a settlement faster, the additional funds may simply add more artillery to the already heated battle. With the added money, both spouses can endeavor to get back at the other simply because they can afford to do so. The spouses may prolong the quarrels over such things as alimony, distribution of the property, or child custody and support, simply to punish the other spouse. Consequently, instead of a faster settlement, the divorce funding may prolong the dispute.

Finally, divorce funding may not provide greater access to justice as many suggest. More properly, the funding brings greater access to the courts, which is very different than access to justice. The funding may bring the couple to court when they may not have otherwise been able to pursue a divorce, but, for a number of reasons, the outcome may not be better. Specifically, the outcome may be worse because: (1) the advance will take funds away from the spouse that would have been used for living expenses; (2) as discussed below, using divorce funding introduces a third-party with very different incentives into the divorce litigation; (3) the third party may attempt to influence the outcome; (4) the attorney may feel pressure to follow requests of the lender instead of the client, because the lender and attorney have an established business relationship as repeat players; (5) the attorney or client may breach the attorney-client privilege by turning over documents to the lender to analyze the case; and (6) because of the increased volume of litigation and cases without merit clogging up the courts, the divorce process may take longer than before. It can hardly be said that greater justice for each spouse is being served with these potential adverse effects.

C. Undesirable Societal Costs if Left Unchecked

The benefits are minor compared to the undesirable costs to society as a result of the divorce funding industry if it is allowed to continue without regulation. Specifically, the United States will see an increase in divorces and the judiciary will suffer increased costs as a result. If unchecked, divorce funders may

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65 BEISNER ET AL., supra note 48, at 4.
66 Id.
67 Id.
incorporate contractual terms in their agreements that are against public policy, and they will almost certainly interfere in the divorce litigation. Each of these societal costs is addressed in succession.

1. An Increase in Divorce Litigation

There will undoubtedly be an increase in the amount of divorce litigation with an increased access to divorce funding. The U.S. Chamber Institute for Legal Reform recommended a complete ban on third-party litigation funding for the very reason that it would increase the overall amount of litigation. Certainly, there will be an increase in divorces filed by couples that should divorce, but for financial reasons, could not. More significantly, there will be an accompanying increase in divorce cases where the couple is better off reconciling. Couples set on getting a divorce will get a divorce with or without the funding, but policies should be in place that will encourage reconciliation rather than removing useful obstacles.

Accompanying more divorce litigation is the heavier burden on the judicial system. “[T]hird party funding does appear to be associated with increased expense to the courts, an increased backlog, and a slowing in average time to completion.” These effects should be avoided, as it is contrary to the judicial system’s goal to ensure speedy adjudication of claims and disputes.

2. Added Expenses to State and Federal Governments

Divorce funding will add significant costs to the state and federal governments. A study by David G. Schramm found that each divorce in Utah cost the state of Utah and the federal government a combined total of $30,000, not including the personal expenses faced by the couple. Included in these costs were child support enforcement, bankruptcies, a reduction in receipts of charitable donations, healthcare costs, utility assistance costs, and “increased costs to society associated with social problems linked to family breakdown.” The total cost of

69 BEISNER ET AL., supra note 48.
70 Indeed, in a survey of divorced couples, over two-thirds of both men and women recommended that couples “contemplating separation [or] divorce avert divorce by ‘working it out’ or ‘seeing a counselor.’” Knox & Corte, supra note 27, at 86–87. “Over three fourths evaluated their adjustment as ‘still healing’ or ‘terrible’ with some ‘suicidal.’” Id.
71 Abrams & Chen, supra note 8.
73 Abrams & Chen, supra note 8.
divorce on the state and federal governments was a total of $33.3 billion per year.\textsuperscript{74} With the increase in divorces, this number will also increase.

This is more significant with divorce funding than with commercial litigation funding. Funding a divorce is different than funding commercial litigation because of a factor unique to individuals—that is, individuals may turn to the state and federal government for living assistance—while the same cannot be said of companies that lose commercial suits. “[A]fter divorce, women and children suffer on average a 73 percent drop in standard of living.”\textsuperscript{75} Divorce is often the catalyst for sending families under the poverty level.\textsuperscript{76} The borrowing spouse will have less to live off of because of the fee charged by the lender. With less money to pay for living expenses, the likelihood increases that divorced individuals will turn to the government for financial support. Divorce funding should be regulated to limit this increased cost to the government.

3. Lending Terms Against Public Policy

There is almost nothing preventing a divorce funder from including in the funding agreement contractual terms that are against public policy. For instance, one lending company puts restrictions on the client’s right to change attorneys.\textsuperscript{77} The company requires that the client get approval from the lender prior to firing their attorney.\textsuperscript{78} Afterward, the client must choose a replacement attorney from the lender’s approved list.\textsuperscript{79} Clients should be free to choose their attorney without such restrictions.

Moreover, nothing prevents a lender from incorporating contract terms requiring the borrowing spouse to seek specified amounts of alimony, child support, or a specific marital settlement, even when the spouse would rather take less and move on. Rather than being able to expedite the dissolution of the harmful relationship, the target amounts specified in the contract may require additional hearings, testimony of the children, or other unwanted legal tactics so as to not violate the terms of the contract. The lender may also include contractual remedies for failing to do so, including higher fees. This should not be allowed.

\textsuperscript{74} Schramm, supra note 72.


\textsuperscript{77} See, e.g., FAQ’s, supra note 52.

\textsuperscript{78} Id.

\textsuperscript{79} Id.
Finally, most divorce funders require that repayment of the divorce advance is due only when the case reaches a settlement. Assuming that staying together qualifies as a settlement—the more likely interpretation and the assumption upon which many of this Note’s arguments rely—divorce funding at the very core is against public policy because the risk borne by the lender is incongruent with the payoff. Even if the couple decides to stay married, the funds will always come due, thus, any argument that the lender “earned” the money by bearing the risk of loss is moot.

4. Third-party Lender Interfering in Litigation

There is an extreme risk that divorce funders will interfere with the litigation by breaching the attorney-client privilege. Prior to funding a divorce, most lenders require the attorney provide information and documents related to the case in order to assess the risk and make an underwriting decision. The lender has great financial incentives to gather as much information as possible, which could lead to breaching privilege.

Aside from a breach of privilege, funders may also interfere with or even attempt to direct the course of the divorce proceeding. Some take an active role in the litigation, claiming to “become business partners” and even require “an in-person meeting” before funding the suit “to decide if [the client and the lender] have the makings of a good relationship.” This is contrary to the normal self-funded divorce, in which the only parties to a divorce proceeding are the spouses.

Most lenders require the borrower to be represented by an attorney, but this seems to be internal policy rather than a mandate by law. Without an attorney advising the borrower, the lender may see the borrower as more malleable, and the lender may advise the borrower in ways to maximize its return on investment. Divorce funders, therefore, may have an incentive to discourage the couple from retaining attorneys, leaving the borrowing spouse vulnerable to manipulation from the lender.

Even with an attorney, the borrowing spouse may feel pressure from the lender (even contractually) pushing for more alimony or more money in the settlement. The lenders are repeat players, compared to the borrower who usually

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82 See, e.g., GET LAWSUIT LOAN, supra note 34.
84 24 AM. JUR. 2D DIVORCE AND SEPARATION § 205 (2010).
will not have more than the one divorce. The borrowing spouse may be naïve and under extreme emotional distress, and may be easily persuaded by the lender to reject a fair settlement. Because attorneys are bound by a client’s objectives relating to acceptance or rejection of a settlement, there is a significant danger that a lender will succeed in improperly influencing a borrower—a risk that is outside the reach of the ethical rules governing attorneys.

In addition to improper influence over the borrowing spouse, there may be improper influence over the attorney as well. Even though there are ethical rules governing attorney conduct, there can be pressure on attorneys from lenders attempting to control the divorce proceeding. This is especially dangerous where the lawyer and attorney repeatedly work together making it unclear whether the

Furthermore, divorce funders may encourage more spending than necessary. Lenders could use scare tactics to encourage a spouse to use expensive investigation of the other spouse of fraud, asset concealment, or encourage the need for forensic accounting. While these may be useful in some cases, they are not required in most.

IV. RECOMMENDATIONS: LEGISLATION REGULATING ATTORNEY—AND LENDER INVOLVEMENT IN DIVORCE FUNDING

To curb the negative effects that most certain will arise with the gaining momentum of third-party divorce litigation finance, states must take two specific steps. First, each state’s bar association ought to adopt rules governing lawyers’ involvement in these funding transactions to better safeguard against violations of the Rules of Professional Conduct. Second, the legislatures must adopt laws to govern non-attorneys involved in funding divorces.

Attorneys should be required to explain the funding transactions to the client. In all instances, the attorney should be required to obtain informed, written consent regarding the funding, spelling out the potential for conflicts of interest between the client and the lender and between the client and the attorney. Also, the attorney should be required to disclose in writing the potential difficulty after reaching a settlement and repaying the advance to pay living expenses or to keep certain assets awarded in the settlement. Requiring this type of up-front disclosure will allow clients to be better informed about the decision to accept funding.

However, these rules governing attorneys would not affect non-attorneys, who are more likely to bring about the negative effects associated with divorce funding. Therefore, the state legislatures should pass laws governing non-attorneys involved in third-party divorce funding. Specifically, the rules adopted should: (1) restrict the instances where divorce funding is allowed, (2) restrict the fee or percentage allowed to be charged by lenders, (3) mandate boundaries for involvement of lenders in the divorce proceeding, (4) require that advances be nonrecourse should
the couple decide to reconcile, (5) require disclosure, and if necessary (6) make certain terms of a contract unenforceable.

A. Allow Divorce Funding Only in Certain Instances

The state legislatures should restrict the use of divorce funding to instances where the policy concerns are not implicated. For example, the states could adopt statutes allowing divorce funding only for one spouse and only in instances involving abuse, neglect, or abandonment; or where one spouse is almost completely cut off from the couple’s finances, provided the remaining marital assets after repayment of divorce funding will be sufficient to pay for necessary living expenses and the clients are thoroughly informed about the potential financial hardships associated with repayment.

Restricting the use of divorce funding accordingly will provide protection from predatory lending while still providing divorce funding to people in divorce proceedings who need it.

B. Restrict the Allowed Fee Percentage

The legislatures should recognize, as the divorce lenders have, that the rates lenders charge for divorce funding are not subject to any limits aside from those to which the borrower agrees. The legislatures should restrict the fees lenders are allowed to charge.

One option for limiting the fees is to subject the divorce funding advances to the state usury caps. In North Carolina, litigation advances are subject to the state usury laws.86 This option puts a strict limit on the fees that funding companies are allowed to charge.

A second option is to set a ceiling for the permissible fee percentage and to exclude certain portions of the settlement from the total from which the fee is calculated. For example, the legislature may limit the advance and fee combined to be no more than 25% of qualifying portions of the settlement. Additionally, the legislatures could exclude spousal support and child support amounts as a factor in calculating the fee. If necessary, the legislature could set a threshold for exclusion of support payments where only the portion of support payments over the threshold may be used in the calculation. These restrictions on the fee will make it more likely that the borrower is able to repay the lender, while still having enough money to provide for their living expenses and children’s needs.

C. Formally Restrict the Involvement of Funders in the Divorce

The legislatures should enact laws that mandate specific disclosures about the rates and terms of litigation funding and prohibit lenders from any control or influence over the suit. One of the biggest dangers associated with divorce funding

is the potential that a third party with a financial incentive to secure a divorce becomes involved in dictating the direction of the divorce. The funder should be restricted to minimal initial contact and updates from the attorney regarding the case. No influence over case strategy should be allowed.

D. Require that All Divorce Funding Be Non-recourse

Divorce funding seems to be a no-risk investment for the lenders. Whether the couple reconciles or finalizes the divorce, either outcome is likely considered a “settlement” requiring the borrower to repay the money. The legislature could enact regulations that require all divorce advances to be nonrecourse. Should the couple decide to stay together, the law would mandate that the borrower owes nothing.

This will have two possible effects. First, it will change the incentives for the funders because the funding company will have to consider the merits of the divorce. Rather than looking only to the total asset amount, the company will assess the likelihood of reconciliation. This will weed out the couples that have great potential for reconciling because they are “too risky” for the funders. In essence, the requirement that the divorce advance be nonrecourse has the effect of encouraging couples to reconcile because it will be more difficult for them to borrow for a divorce. However, in the instances where divorce is necessary, divorce funding will be easily accessible because the funder will advance the money in instances where divorce is likely. Therefore, in marriages where divorce is more likely and justified, such as those involving abuse, cruelty, infidelity, criminal behavior, or endangering the spouse or children, the lenders will want to fund the divorce.

There is an inherent danger in requiring that divorce advances be nonrecourse—it will emphasize a third party’s monetary incentive for the couple to secure a divorce. It has long been prevented for attorneys, and the same rationale applies to non-attorneys. Therefore, the only way this should be adopted is in conjunction with limits on the fees and regulations restricting divorce funders’ involvement in the litigation.

The second effect from requiring all advances to be nonrecourse is that lenders will structure the funding as a typical loan. This would subject the lenders to usury caps, again bringing about more protection for the borrower.

E. Require Disclosure of Third-party Funding

Borrowers may also benefit from the legislature requiring disclosure to the court when a spouse uses divorce funding. Disclosure will have the effect of keeping lenders more forthright about the lending terms of the contract, because the contracts would be reviewable by the judge. The judges would become familiar with which lenders were reputable, and which were not, thus being able to inspect more thoroughly the less reputable lenders.
F. Make Some Contract Terms Unenforceable

It may be too difficult or burdensome to require all divorce lenders to register with the state, but perhaps a simpler approach would be to make certain contract terms unenforceable. The court would have the benefit of hindsight in holding that certain terms violated public policy. For instance, terms (1) requiring the borrowing spouse to pay the lender a portion of spousal or child support amounts, (2) requiring approval by the lender before changing attorneys, or (3) dictating when the client can accept a settlement should be unenforceable as against public policy.

V. Conclusion

Third-party divorce funding institutions claim their services lead to a win-win situation for all involved. Lenders assert that it provides a way to “level the playing field” for couples involved in a divorce, but also creates a profitable enterprise for the lender. In reality, the economic, practical, and legal consequences of such funding make its use undesirable in most situations. Moreover, divorce lenders have enormous financial incentives that do not necessarily align with the best interests of the separating parties.

Due to the lack of regulations, the growing use of divorce funding will increase the number of divorce cases, burden the judicial system and increase the cost to state and federal governments. Divorce funding also encourages lenders to utilize contractual terms that violate public policy and interfere in the divorce proceedings. Therefore, the state bar associations and state legislatures should adopt rules and laws to govern the use of third-party divorce litigation funding to curb these negative effects.