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Ninth Circuit Asks The New York Court of Appeals Whether Litigation Financing Agreements Are “Usurious”

Client Alert | July 10, 2020

The New York Court of Appeals recently accepted a certified question from the United States Court of Appeals for the Ninth Circuit that could have far-reaching consequences for the litigation funding industry. Litigation funding typically involves a funder lending money to a client and/or her counsel on a non-recourse basis to pursue legal action in exchange for a share of the proceeds of the litigation. The tripartite relationship between funder, attorney, and client has raised a host of legal issues in the past, and this certified question reflects an important issue relating to so-called “portfolio” litigation funding. Portfolio litigation funding occurs where a funder lends money to an attorney and her clients to use in specific cases in exchange for prospective payment not just from those cases but also from cases where lent funds may not actually be used.

The certified question presents an emerging issue related to portfolio litigation funding:

Whether a litigation financing agreement may qualify as a “loan” or a “cover for usury” where the obligation of repayment arises not only upon and from the client’s recovery of proceeds from such litigation but also upon and from attorney’s fees the client’s lawyer may recover in unrelated litigation?

And, if so, what are the appropriate consequences, if any, for the obligor to the party who financed the litigation, under agreements that are so qualified?

Fast Trak Inv. Co., LLC v. Sax, 962 F.3d 455, 459 (9th Cir. 2020)*, certified question accepted sub nom. Fast Trak Inv. Co., LLC v. Sax*, 2020 WL 3420856 (N.Y. June 23, 2020). In other words, the Court of Appeals will decide whether a portfolio litigation funding agreement is a “loan” and subject to New York’s usury laws where the agreement requires an attorney to pay the funder attorneys’ fees from cases *unrelated* to the litigation the funder is financing directly. How the Court of Appeals decides the question could have a wide-ranging impact on the growing litigation finance industry in New York and how such issues are resolved in federal and state appellate courts across the country.

Certification Procedure

Certification is an important procedure whereby certain appellate courts that are grappling with a complex, novel issue of New York law can petition New York’s highest court for an answer to the question. 22 N.Y.C.R.R. § 500.27(a). Under New York law, certification requires only that (1) there be no controlling New York Court of Appeals decision on the question at issue; and (2) the certified question is determinative of the outcome of the case. *Id.* Some courts impose additional requirements before they will submit a certified question. For example, the Second Circuit considers (1) whether “the New York Court of Appeals has addressed the issue and, if not, whether the decisions of other New York courts permit [the court] to predict how the Court of Appeals would resolve it; (2) whether “the question is of importance to the state and may require value judgments and public

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policy choices"; and (3) whether the question is "determinative of a claim." *Expressions Hair Design v. Schneiderman*, 877 F.3d 99, 105 (2d Cir. 2017) (internal quotation marks omitted).

Courts are often reluctant to certify questions to the Court of Appeals because certification can result in added costs and potential delay by requiring the parties to effectively take on an interlocutory appeal before New York's high court. For that reason, certification is rare. In 2019, the New York Court of Appeals answered only three certified questions and had just two pending at the end of 2019.[1] But as the court in *Fast Trak* demonstrated, a certifying court may find certification appropriate, either upon a party's request or *sua sponte*, when a case turns on an ambiguous question of state law that is particularly important and "likely to have wide-reaching implications." 2020 WL 3092063, at *9 (noting that certification "helps build a cooperative judicial federalism" (internal quotation marks omitted)).

The New York Court of Appeals has discretion to determine both whether to accept the certification and what procedure it will undertake in answering the question. 22 N.Y.C.R.R. § 500.27(d)-(e). In general, the Court of Appeals accepts only issues that are likely to arise in state court proceedings and are "fact and case-specific," rather than "[a]bstract or overly generalized questions" that might "curb [its] ability to promulgate a precedentially prudent and definitive answer to a law question." *Yesil v. Reno*, 92 N.Y.2d 455, 457 (1998).

***Fast Trak* and Its Potential Impact on Litigation Finance**

In *Fast Trak*, the Ninth Circuit considered whether a portfolio litigation funding agreement violates New York's usury laws. 962 F.3d at 458. Under the funding agreement at issue, which was governed by New York law, Fast Trak provided funding for clients bringing specific lawsuits Sax brought as the attorney of record, in exchange for a portion of the proceeds in those cases *and* his attorney fees in separate unrelated cases. *Id*. When Sax obtained proceeds for attorney fees (presumably through guaranteed hourly fees, though the opinion is unclear on this point) in those unrelated cases and refused to pay them, Fast Trak sued him for, among other things, breach of contract and breach of fiduciary duty. *Id.* at 461. In his defense, Sax argued that the contracts constituted usurious loans and were therefore unenforceable. *Id.* at 461-62.

New York usury laws typically apply only to agreements that constitute a "loan." *Id.* at 458. To qualify as a "loan," "the purported lender must have the right to collect from the purported borrower in absolute terms—that is, a right not dependent on the occurrence of any condition precedent." *Id.* at 465. Based on this principle, New York courts have found that litigation finance does not constitute a "loan" when the finance agreement is contingent upon success in a single case. *See Cash4Cases, Inc. v. Brunetti*, 167 A.D.3d 448 (1st Dep't 2018). As the Ninth Circuit stated, however, such an agreement stands in "sharp contrast" to the agreement between Fast Trak and Sax, where repayment "was secured in each instance with [Sax's] future attorney fees in about five to ten unrelated cases," and thus repayment was "all but guaranteed." 962 F.3d at 467.

To that end, the Ninth Circuit asked the Court of Appeals to address whether an agreement like that between Saks and Fast Trak constitutes a "loan" or a "cover for usury." The Ninth Circuit deemed that issue sufficiently novel and its effect on the rapidly growing litigation finance industry sufficiently important to seek certification. *Id.* at 459 n.3 (citing Ass'n of the Bar of the City of N.Y. Comm'n on Prof'l and Judicial Ethics, Formal Op. 2011-2, 2011 WL 6958790 at *1). Certification was particularly important here, according to the Ninth Circuit, because "the result is likely to have wide-reaching implications," and because "[o]ther states that have addressed [the issue] have reached conflicting results." *Id.* at 468. A court in Colorado, for instance, concluded these portfolio litigation funding agreements constitute "loans," whereas another in Texas came out the opposite way. *Id.* at 468 n.8.

Resolution of this issue could impact both current and future litigation finance agreements and particularly portfolio litigation finance agreements. If the Court finds the litigation finance agreement in *Fast Trak* to be usurious, it also has indicated that it will determine "the appropriate consequences, if any, for the obligor to the party who financed the litigation, under agreements that are so qualified." 962 F.3d at 459. The Court could, for example, find the contract void, providing the obligor with a windfall; cancel the interest obligation; or revise the obligation to a pay a non-usurious rate. The precise impact of finding these portfolio litigation finance agreements to be "loans" is uncertain, but it may have far-reaching effects.

Gibson Dunn will continue to monitor developments in *Fast Trak* and other important cases in the New York Court of Appeals.

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[1] *See* 2019 Annual Report of the Clerk of the Court of Appeals at 6, App'x 5, https://www.nycourts.gov/ctapps/news/annrpt/AnnRpt2019.pdf.

Gibson Dunn's lawyers are available to assist with any questions you may have regarding these developments. For further information, please contact the Gibson Dunn lawyer with whom you usually work, or the following authors:

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