To be Argued by:
THOMAS J. FLEMING
(Time Requested: 10 Minutes)

CTQ-2020-00006
United States Court of Appeals for the Ninth Circuit Case No. 18-17270
United States District Court, Northern District of California
Case No. 4:17-cv-00257-KAW

Court of Appeals

of the

State of New York

FAST TRAK INVESTMENT COMPANY, LLC,
a Delaware limited liability company,

Plaintiff-Respondent,

– against –

RICHARD PHILIP SAX, individually and as principal for The Law Offices of Richard Sax; LAW OFFICES OF RICHARD SAX, a sole proprietorship,

Defendants-Appellants.

BRIEF FOR PLAINTIFF-RESPONDENT

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DISCLOSURE STATEMENT

Pursuant to 22 NYCRR 500.1(f), Fast Trak Investment Company, LLC hereby discloses that it has no parent company and no subsidiaries or affiliates.

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Plaintiff-Respondent Fast Trak Investment Company, LLC ("Fast Trak"), by its attorneys, respectfully submits this Brief in opposition to the Brief filed by Defendant-Appellant Richard Sax.

I. CERTIFIED QUESTIONS PRESENTED

1. Whether a litigation finance 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 the attorney's fees the client's lawyer may recover in unrelated litigation?

2. 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?

II. STATEMENT OF THE CASE

In 2013, Fast Trak advanced $132,000 to Richard Sax and his law firm ("Sax") pursuant to litigation funding agreements under which it purchased an interest in five personal injury cases. The agreements provided that Fast Trak would receive stipulated amounts only upon successful recoveries in the five primary cases, with the amounts increasing over time. As a condition to the financing, Sax also agreed to cover any shortfall in the primary cases with the legal fees that he might receive in twelve other cases. There is no dispute that Fast Trak had no recourse against Sax personally. Fast Trak would earn a return on its investment solely from the outcome of specified civil actions that Fast Trak did not, and could not, control.

The five primary cases were a bust, as were most of the twelve additional cases. The recoveries in ten of the secondary cases provided Fast Trak with a modest return on its investment. The addition of two other recoveries in the secondary case, according to Sax, rendered the funding arrangement a usurious "loan" entitling him to retain Fast Trak's money. With the benefit of hindsight, Sax has argued that the addition of the twelve cases made a large recovery by Fast Trak a certainty. The record is barren of any evidence that the twelve cases provided any assurance of a recovery, much less in an amount and on a timetable that would result in a specific return.

Sax has acknowledged that the primary funding agreements were not loans and therefore not subject to New York's usury laws. This is not a surprising concession. The hallmark of a "loan" for usury purposes has always been the certainty of the borrower's obligation to repay principal plus interest in an amount that violates either G.O.L. 5-501 or Penal Law 190.40. The primary funding agreements offered no certainty at all, a fact confirmed by the dismal results in those cases. Of course, nothing was guaranteed and he suffered defense verdicts in three cases, a *de minimis* recovery in a fourth, and prevailed in one matter where Fast Trak had a very small stake.

New York has long contrasted investments, which carry risk of loss and uncertainty of return, with loans, where Courts stand ready to enforce obligations to pay principal and interest. In the investment world, high-risk ventures offer high returns to those willing to place their capital in jeopardy. New York Courts have consistently recognized that the usury laws have no place where investors have forsaken the certainty of a specific return for the possibility of financial success that far exceeds the returns permitted under G.O.L. 5-501 and Penal Law 190.40.

Fast Trak's agreements covering Sax's possible legal fees in twelve additional cases do not change the legal analysis. Fast Trak was at all times subject to the risk that those cases would produce modest recoveries or even none at all. Sax's hollow claim that the twelve cases had a guaranteed outcome was made only

after the results were in. It rests on 20/20 hindsight. More important, Sax offers nothing, literally nothing, to support the alleged certainty. Anyone with experience in civil litigation knows full well that each case is subject to a myriad of uncontrollable and unpredictable forces, either at trial or in settlement, including the performance of witnesses and counsel, the determinations of judges and juries, the timing of any resolution, and the ability to enforce any award. Fast Trak had even greater risk since it was powerless to direct the civil cases. Sax and his clients retained all decision-making power.

Intent is an essential element of usury. For this reason, the transaction must be analyzed *at its inception*, with usury determined at that date. According to Sax, he could have taken Fast Trak's money in March 2013 and kept it before anyone knew the results in the twelve cases involving contingent legal fees. Sax's "crystal ball" approach to determining future recoveries in litigation—or in investing in general—would fundamentally re-write the law of usury in New York. There is simply no dispute that Fast Trak took genuine risk when it invested in the Sax portfolio of cases, as litigation is by definition uncertain in outcome.

This case provides compelling evidence of the uncertainty of civil litigation. Fast Trak has been seeking to enforce unambiguous written agreements since 2017 and now finds itself traveling across the continent to defend the trial court's award of summary judgment.

The simple answer to the first certified question, we respectfully submit, is that the litigation funding agreements are not "loans" under G.O.L. 5-501 or Penal Law 190.40. For this same reason, they cannot be a "cover for usury," a term applied to loans and/or interest dressed up in other guise.

One aspect of Sax's "cover for usury" theory deserves special mention. The transaction with Sax has a nominal nexus to New York since Sax is a California attorney who sought funds for his law firm there. Our State's usury laws apply through a choice of law clause in the funding agreements. Fast Trak structured the agreements to provide that New York law would govern, guided by extensive New York precedent holding that litigation funding is not a "loan" for the purposes of our usury laws. The "cover for usury" doctrine applies to unmask actual loans disguised as another type of transaction. Fast Trak spelled out the terms of its funding arrangements in plain English and actually chose New York law to govern. These undisputed facts are irreconcilable with the deception required under the "cover for usury" doctrine.

The second certified question seeks guidance on the remedies available under New York's usury law, including the interplay between G.O.L. 5-501 and Penal Law 190.40 and the meaning of the term "void" in G.O.L. 5-511. For the reasons set forth in detail below, should the Court find it necessary to address this question, the Court should permit Fast Trak to recover the amount invested with

the returns permitted by contract, with lawful interest or some lesser remedy that would eliminate the prospect of a windfall to Sax. This remedy is appropriate in light of, among other things, the fact that the litigation funding was not a promissory note and never had a fixed or certain return. To treat such a financing arrangement as a promissory note would have adverse consequences across a wide range of commercial activity.

Our proposed response to the second question is informed by recent developments in usury law litigation. The usury laws have always been intended to protect individuals; the Legislature extended their protections to corporations in 1965 in response to loan sharks pressuring individuals to borrow in corporate form. In recent years, the reported cases make clear that those invoking the usury laws are, for the most part, sophisticated corporate borrowers and merchants. Banks and other conventional sources of capital are often unwilling to extend credit to distressed or nascent businesses. To raise funds, these enterprises offer high returns to investors who are only willing to provide capital if the returns are sufficient to reward the risk. These funding sources demand high returns for a simple reason: Some investments will be a total loss and only through high returns on successful investments can they yield a profit. The sale of future accounts receivable and promissory notes with equity features are two financing transactions that offer capital into this market. Litigation funding to law firms, like Sax, is another. The

reported cases make clear that these sophisticated players are the primary litigants alleging usury. The recurring pattern in these cases is a commercial venture claiming that the investment is a "loan," and therefore "void" under Penal Law 190.40 or G.O.L. 5-511, entitling the recipient to keep the investor's funds. New York's usury laws were never intended to apply to sophisticated commercial enterprises, merchants, and law firms that raise capital through alternative financing arrangements that do not involve promissory notes and fixed obligations.

III. PROCEEDINGS IN THE FEDERAL COURTS

Plaintiff-Appellee Fast Trak commenced this action in the United States District Court for the Northern District of California in June 2017 seeking to enforce its rights under a series of litigation funding agreements with Defendant-Appellant Richard Sax, a member of the California Bar, and his law firm. (R. 443-543) The agreements, which were signed in early 2013, provided funding in connection with five personal injury cases where Sax represented the plaintiff. Each funding was documented with an Assignment, Sale, Springing Assignment & Equitable Lien Agreement (the "Primary Agreement") under which the "Purchaser [Fast Trak] has agreed to purchase from the Seller a portion of the Proceeds…." (R. 61, 76, 90, 98, 106, 121, 139) Each Primary Agreement defined the "Proceeds" as "[a]ny sums of monetary sums recovered" in the specific personal injury litigation. Each Primary Agreement recited, "this transaction is a purchase and sale

and is not a loan." (R. 61) Sax signed each Primary Agreement as counsel of record, obligating himself to assure delivery of any Proceeds to Fast Trak. The five personal injury cases covered by the Primary Agreements are referred to as the "Primary Cases."

As a condition to the funding in the Primary Agreements, Fast Trak entered into Assignment, Springing Assignment and Equitable Lien Agreements (the "Secondary Agreements," collectively with the Primary Agreements, the "Agreements"). In the Secondary Agreements, Sax agreed to pay the "Proceeds" from a pool of other civil cases in the event Fast Trak was not paid in full on a Primary Case. (81-89; 114-120; 130-138; 147-153). For the five Secondary Agreements, the "Proceeds" was defined as "any sums of money … paid to … the Law Offices of Richard A. Sax … as and for legal fees." (R. 148) Each Secondary Agreement identified 3 to 12 civil actions in which Sax represented the plaintiff, including the Primary Cases. The cases covered in these agreements are referred to as the Secondary Cases.

In total, Sax agreed that his legal fees in the twelve Secondary Cases and the five Primary Cases, would cover any shortfall in the Primary Agreements.

According to his law firm's website, Sax is a trial lawyer with a varied practice and over 35 years' experience. In each Secondary Agreement, Sax represented that he had "sought and received independent tax, financial, and legal

advice with respect to this transaction from [his] own attorneys, accountants, financial and tax advisors." (R. 116) He also represented that he had "a net worth greater than Two Million ($2,000,000) Dollars." (R. 116) In each of the Primary and Secondary Agreements, the parties agreed that New York law would govern. (R. 78; 84-92; 100; 208; 128; 135; 141; 150) Fast Track invested a total of $132,000.00 in the Primary Cases. (R. 21) Sax was not new to litigation funding. He used $59,644.67 of Fast Trak's funds to pay off a prior funding agreement that he had with Alliance Legal Solutions. (R. 155)[1]

The Agreements were unequivocal that Fast Trak's right to payment was contingent upon recoveries in the Primary and Secondary Cases. Each Primary Agreement had a schedule providing the amount to be paid from the Proceeds, with the amount fixed for six months and adjusting twice a year. The schedule in the *Wolfe Lee* case, for example, provided Fast Trak with a return of as much as 41% on its investment if paid within six months; as much as 68% if paid between six months and a year; as much as 101% if paid between one year and eighteen months; and similar increases out for three years, at which point the increases

[1] With one modest exception, the funds went to Sax or Alliance. Based on the Secondary Agreements, Fast Trak understands that the proceeds were used to finance Sax's prosecution of the Primary Cases, from which he hoped to recover substantial legal fees. The Ninth Circuit noted that the funds were all wired to Sax, except for one payment in January 2013. 962 F.3d at 459. The payoff of the Alliance lien indicates that either Alliance was unwilling to advance more funds to Sax or Fast Trak offered better terms.

ceased. (R. 139) Each schedule had different returns and different treatments after three years.

Following discovery regarding the recoveries in the Primary and Secondary Cases, Fast Trak filed a Motion for Summary Judgment on the First Cause of Action, Breach of Contract, and the Third Cause of Action, Breach of Fiduciary Duty. Sax opposed the motion arguing that the contracts were "illegal, usurious, and champertous transactions." (R. 25) Sax argued that the Agreements were "loans," because Fast Trak could recover monies from a "lengthy list of secondary" cases as "backup collateral" in order to collect on its investment if the Primary Cases did not realize sufficient proceeds. (R. 26) Sax offered no further evidence to suggest the Secondary Cases had any special qualities to differentiate them from ordinary civil litigation.

In a Decision dated May 11, 2018, District Court awarded Fast Trak summary judgment on liability. (R. 19-29) Applying New York law, the District Court ruled that the Primary and Secondary Agreements were "purchase agreements rather than loans." (R. 27) The District Court found that "repayment was contingent on Defendants' recovery, such that repayment could not be considered absolute," citing *Capital Asset Corp. v. F & B Fuel Oil Co.*, 58 Misc. 3d 1229(A) (Sup. Ct. Westchester Co. 2018). (R. 26) The District Court observed, "the next quintessential factor in determining the definite nature of a repayment

requirement is whether the agreement has a finite term or not." (R. 27) The District Court noted that no specific date was set for payment and "when, payment is not set at a fixed time, the hallmark of a loan is missing." (R. 27)

The District Court awarded $315,601 as damages for breach of contract in a Decision dated August 21, 2018. (R. 9-18) The District Court found that only one of the five Primary Cases resulted in a recovery. Three of the Primary Cases were defense verdicts. The recoveries in the *Wolfe Lee* case went to pay medical liens, leaving nothing for Fast Trak. (R. 522) The recovery in the *Gadow* case was substantial ($199,000), but Fast Trak had only invested $3,000 and so its recovery was $13,698. Sax earned $79,500 in legal fees in *Gadow*, which he was obligated to pay to Fast Trak in the Secondary Agreements. He failed to do so. Sax recovered legal fees in ten of the twelve Secondary Cases. The District Court found that Sax owed $13,698 for the one successful Primary Case and $301,902 from his legal fees in the remaining cases. (R. 15)

The District Court's computation relied on a Declaration from Fast Trak executive Jamie Burke, which listed the attorneys' fees in each of the Secondary Cases. (See Decl. of Jamie Burke, PACER Dkt. No. 75-1 (July 3, 2018).) Mr. Burke's Declaration confirms that Sax received fees in three cases that constitute approximately two thirds of the recovery, with six other cases producing recoveries

of $10,000 or less. The recoveries paid in full the Primary Agreements for three cases, with one other Primary Agreement paid in part and another not paid at all.

The United States Court of Appeals for the Ninth Circuit elected to certify the two questions now before the Court. The Circuit Court perceived a lack of clarity in New York law on the treatment of the litigation funding agreements in general and more specifically, those involving arrangements like the Secondary Agreements. Citing *Rubinstein v. Small*, 273 A.D. 102 (1st Dep't 1947), the Circuit Court recognized a line of authority holding, "For a true loan it is essential to provide for repayment absolutely and at all events or that the principal in same be secured as distinguished from being put to hazard." *Fast Trak Inv. Co., LLC v. Sax*, 962 F.3d at 455, 465 (9th Cir. 2020), *certified question accepted*, 35 N.Y.3d 997 (2020). The Circuit Court noted two potential lines of New York precedent with a contrary stance. The Court cited *Echeverria v. Lindner*, 7 Misc. 3d 1019(A) (Sup. Ct. Nassau Co. 2005), for the possibility that a litigation funding might be a "loan" where there was "a very low probability that judgment would not be in favor of the plaintiff." *Fast Trak Inv. Co., LLC v. Sax*, 962 F.3d at 466 (citing *Echeverria*, 7 Misc. 3d 1019(A)). The Ninth Circuit also cited precedent holding that a contract might be a loan where "the agreement was not intended for the purpose indicated on its face but as a mere device or subterfuge to conceal a loan of money…." 962 F.3d at 466 (*quoting Orvis v. Curtiss*, 157 N.Y. 657, 661 (1899)). The Ninth

Circuit offered no explanation how the litigation funding agreements with Sax might be a "subterfuge to conceal a loan."

The Ninth Circuit concluded, "whether New York law permits a defense of usury in these circumstances is a question for which no controlling precedent of the Court of Appeals exists. Because the resolution of this question will determine the result of this case, we believe certification is proper." (Certification Order, p. 24) The Ninth Circuit went on to say that "We do not intend our framing of this question to restrict the New York Court of Appeals' consideration of any issues that it determines are relevant." (Certification Order, p. 24)

IV. FIRST QUESTION PRESENTED

1. *Whether a litigation finance agreement may qualify as a "loan" or a "cover for usury" where the obligation of repayment arises not only from the client's recovery of proceeds from such litigation but also upon and from the attorney's fees the client's lawyer may recover in unrelated litigation?*

Based upon the facts presented to this Court, the unequivocal answer is "No."

A. The Standard of Review

Under New York's Constitution, the Court of Appeals may accept a certified question for review that "may be determinative of the cause then pending in the certifying court ..." N.Y. Const. Art VI § 3((b)(9)); *see Retail Software Services,*

Inc. v. Lashlee, 71 N.Y. 788 (1988) (declining to answer certified question involving personal jurisdiction as "not determinative"); *Yesil v. Reno,* 92 N.Y.2d 455 (1998) (declining to answer certified question regarding personal jurisdiction over federal official as "not determinative"). The Court must accept the record presented to the Ninth Circuit in formulating the certified question. The Court's province is bounded by "questions of New York law … which may be determinative." 22 NYCRR 500.17 (b).

The certified question is framed by the record and should be answered based on the facts presented. *See Cont'l Cas. Co. v. Nat'l Slovak Sokol*, 269 N.Y. 283, 288 (1936) ("[i]n answering a certified question, we interpret it as concrete and as based on the particular record before us and not as an abstract question"). In *Engel v. CBS, Inc*., 93 N.Y.2d 195 (1999), for example, the Court was presented with a question from the Second Circuit whether the element of special injury in a malicious prosecution claim could be satisfied absent a provisional remedy in the earlier action. The Court considered the question with reference to the specific injury claimed by plaintiff, observing:

> Notwithstanding this clarification, under the specific facts given to this Court on the certified question, Engel has not shown the requisite added grievance. Engel's allegations, as characterized by the Second Circuit, do not allow the inference that his representation of Scholz was actually undermined. Although other cases certainly may present situations where a lawyer sued will have his or her ability to represent a client sufficiently undermined

> to allow an inference of special injury, the factual allegations of injury here, which we are bound to accept, are not enough to constitute such special injury. *Construing the question in this way*, we answer the certified question in the negative.

Id. at 199 (emphasis added).

The *Engel* question, as here, arose on summary judgment. The Court left the proper determination on summary judgment to the Second Circuit, with the benefit of its answer "construing the question as we do." *Id*. at 207*; see Liriano v. Hobart Corp.*, 92 N.Y.2d 232 (1988).

B. A Litigation Funding Arrangement with a Possible Recovery from Legal Fees in Additional Cases Is Not a Loan

"In 1787, this State enacted a usury statute which barred the taking of interest in excess of 7% by means of any corrupt bargain. (L 1787, ch 13.) In subsequent years, a generalized usury statute was enacted (L 1789, ch 538 [formerly General Business Law, § 370 et seq. from which General Obligations Law, § 5-501 et seq. is derived]) as were a number of specialized usury statutes to address the lending transactions of certain banking organizations…." *Freitas v. Geddes Sav. & Loan Assn.*, 63 N.Y.2d 254, 258 (1984). Section 5-501 of the General Obligations Law codifies civil usury as follows:

> (1) The rate of interest, as computed pursuant to this title, *upon the loan or forbearance of any money, goods, or things in action*, except as provided in subdivisions five and six of this section or as otherwise provided by law,

> shall be six per centum per annum unless a different rate is prescribed in section fourteen-a of the banking law.
>
> (2) No person or corporation shall, directly or indirectly, charge, take or receive any money, goods or things in action as interest *on the loan or forbearance of any money, goods or things in action* at a rate exceeding the rate above prescribed. The amount charged, taken or received as interest shall include any and all amounts paid or payable, directly or indirectly, by any person, to or for the account of the *lender* in consideration for making the *loan or forbearance* as defined by the superintendent of financial services pursuant to subdivision three of section fourteen-a of the banking law except such fee as may be fixed by the commissioner of taxation and finance as the cost of servicing loans made by the property and liability insurance security fund.

N.Y. G.O.L. 5-501(1)-(2) (emphasis added).

In 1965, New York adopted a criminal usury statute, which likewise incorporates the phrase "loan or forbearance of any money…." and establishes a higher interest rate, "exceeding twenty-five per centum per annum," as a predicate for a felony. N.Y. Penal Law 190.40.[2]

Consistent with the statutory language and established precedent, New York courts have repeatedly held that "[u]sury laws apply *only* to loans or forbearances, not investments," and "[i]f the transaction is not a loan, there can be no usury…."

[2] New York's usury laws come with multiple exceptions and limitations. Civil usury, for example, does not apply to a loan in excess of $250,000, while the Penal Law does not apply to loans in excess of $2.5 million. G.O.L. 5-501(6)(a) & (b). In addition, corporations and limited liability companies may only raise usury as an affirmative defense. N.Y.G.O.L. 5-521(i); N.Y.L.L.C. L. 1104(c). *See Intima-Eighteen, Inc. v. A.H. Schreiber Co.*, 172 A.D.2d 456, 456 (1st Dep't 1991).

Seidel v. 18 E. 17th St. Owners, Inc., 79 N.Y.2d 735, 744 (1992) (emphasis added) (citations and internal quotations omitted); *Schermerhorn v. Talman*, 14 N.Y. 93, 115 (1856) ("[t]o constitute usury there must be a loan of money or its equivalent.").

New York courts have made clear that a "loan" for usury purposes requires an "absolute" repayment obligation. In *Orvis v. Curtis*, 157 N.Y.657 (1899), this Court distinguished an advance to a joint venture, holding "[t]he fact that one of them may have advanced the capital and the other has agreed that, in consideration of such advance, he should participate more largely in the profits, does not convert such an agreement into a loan of money." *Id.* at 662. Similarly in *Leavitt v. Delauny*, 4 N.Y. 363 (1850), the Court held that an advance payable in foreign currency which fluctuated in value did not qualify as a "loan." In a loan, the Court explained, "the lender's principal never was in any hazard, as he was, at all events, sure of having that…." *Id.* at 369.

Applying these principles, lower courts have formulated a three-part test, in the context of accounts receivable financing, to determine whether an advance is a "loan." Focusing on whether the repayment obligation is absolute or contingent, trial and appellate courts have looked to (1) whether there is a reconciliation provision; (2) whether the agreement has a finite term; and (3) whether there is any recourse should the merchant declare bankruptcy. *LG Funding LLC v. United*

Senior Properties of Olathe, LLC, 181 A.D.3d 664 (2d Dep't 2020); *see PIRS Capital, LLC v. D&M Truck, Tiure & Trailer Repair, Inc., et al.,* 2020 WL 4913201, 2020 N.Y. Slip Op. 20205 (Sup. Ct. N.Y. Co. August 17, 2020); *Yellowstone Capital LLC v. Central USA Wireless LLC*, 60 Misc.3d 1220(A) (Sup. Ct. Erie Co. 2018) (collecting 38 cases). A "reconciliation provision" permits a merchant to reduce the payment obligation based on declining collections, thereby placing repayment in jeopardy. Without a "finite term," the financing source has no assurance of repayment or a specific return on the advance. The absence of recourse in the event of bankruptcy, such as through a personal guarantee, also makes the advance contingent. None of these factors are present in the Primary and Secondary Agreements. Fast Trak was at all times subject to the risk that the civil cases would not reach the level of success that produced a return on its investment.

A review of the specifics of the Fast Trak agreements with Sax confirms that the purchase of interests in the Primary Cases was not a loan. Fast Trak had no assurance of any return and no date was set for repayment. Fast Trak advanced a total of $132,000 in 2013 without any personal guarantee from Sax and without any recourse beyond the specified cases. 962 F. 3d. at 459. From an investment perspective, the Primary Cases were an abysmal failure, with four producing no recovery.

Although the Secondary Agreements may have improved Fast Trak's investment prospects, they do not alter the legal analysis. Each of the Secondary Cases was subject to the same litigation risk as the Primary Cases. It is beyond dispute that the additional cases could have performed poorly. In fact, two were defense verdicts and most produced nominal amounts of legal fees. From two cases, Sax recovered approximately $146,000 in legal fees. (See Decl. of Jamie Burke, PACER Dkt. No. 75-1 (July 3, 2018).) Sax offers no evidence that these two cases were not subject to the risks that apply to civil litigation across the board. Without these two recoveries, Fast Trak would have received $169,544, a return of approximately 7% per annum on its investment in the Primary Cases.[3] The amount earned by Fast Trak, moreover, was a function of the timing of the payment. Had Sax resolved all of the cases within 12 months, Fast Trak would be owed far less, with Sax keeping any excess. The amount due to Fast Trak grew exponentially because Sax failed to pay the sums on completion of a case and further, concealed the outcomes from Fast Trak.

Sax's core theory—that Fast Trak did not have risk—is contrary to New York law and the actual experience of anyone who has participated in the civil litigation process. In *In re Lawrence*, 24 N.Y.3d 320 (2014), this Court acknowledged the inherent uncertainty of litigation, upholding a retainer

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[3] The return is based on a four year payback period, namely 2013 through 2017.

agreement in which the law firm went from hourly billing to a contingent fee arrangement after it had received $18 million in fees. The change in the fee arrangement occurred after the client had received a $60 million settlement offer; a short while later the case settled, resulting in a $44 million contingent fee. The Court reasoned:

> We agree with Graubard that a hindsight analysis of contingent fee agreements not unconscionable when made is a dangerous business, especially when a determination of unconscionability is made solely on the basis that the size of the fee seems too high to be fair (*see In re Smart World Tech., LLC,* 552 F.3d 228, 235 (2d Cir. 2009) ("the fact that contingency fees may appear excessive in retrospect is not a ground to reduce them because early success by counsel is always a possibility capable of being anticipated").

Id. at 340.

The Court's rejection of "hindsight analysis" applies with equal force in the usury context. In *Halsey v. Winant*, 258 N.Y. 512 (1932), the Court reviewed a financing arrangement that was fraught with uncertainty but which produced a favorable return. Rejecting the claim that the financing was usurious, the Court warned that "To hold, long after the transaction upon the grounds advanced, that the transaction was fraudulent under the statute, seems to us to disregard the realities and substitute therefore pure speculation." 258 N.Y. at 532.

The need for certainty of payment, as well as the impropriety of hindsight determinations, is underscored by the fact that a usurious loan may be subject to

criminal penalties. For this reason, New York courts have consistently held that intent is an essential element in a usury claim, while recognizing that intent may be presumed where the loan agreement on its face provides for a usurious rate of interest. *Giventer v. Arnow*, 37 N.Y.2d 305, 309 (1975) ("when … the evidence is conflicting, the lender is entitled to a presumption that he did not make a loan at a usurious rate"); *see Blue Wolf Capital Fund II, L.P. v. Am. Stevedoring Inc*., 105 A.D.3d 178, 185 (1st Dep't 2013); *see also Fareri v. Rain's Int'l, Ltd*, 187 A.D.2d 481, 483 (2d Dep't 1992). "It is a just requirement that all the facts constituting the usury should be provided with reasonable certainty, and that they shall not be established by mere surmise and conjecture, or by inferences entirely uncertain." *White v. Benjamin*, 138 N.Y. 623, 624 (1893).

Consistent with these requirements, this Court has recognized, "The imposition of civil liability for usury is closely circumscribed by the rules of construction traditionally applied to usury statutes, and the substantial burden of proof to be borne by the borrower which is only satisfied *by clear and convincing*

evidence of each element of usury, including usurious intent." Freidas, 63 N.Y.2d at 260-61 (emphasis added).

To establish the intent appropriate for criminal punishment, the lender in an illegal loan must be *certain* that he or she will receive an excessive rate of interest. The treatment of a transaction as a usurious loan must therefore be determined at inception. In other words, when Fast Trak invested in the Primary Cases, it must have known, beyond question, it would receive a usurious return through the Secondary Cases.

The intent requirement cannot be established by investments such as the Fast Trak Agreements, which produce uncertain returns and may produce no return at all. The fact that Fast Trak received the benefit of Sax's potential legal fees in the Secondary Cases is insufficient, as a matter of law, to eliminate risk and produce the requisite certainty of an unlawful return. In this regard, the Secondary Agreements are noteworthy for what they do not contain. If Sax were unsuccessful in the Secondary Cases, he had no obligation to deliver substitute cases. Nor was he personally liable if the outcomes were adverse.

For all of these reasons, lower courts have consistently ruled that litigation funding contracts are not "loans" under G.O.L. 5-501 or Penal Law 190.40, accepting the proposition that "[w]here payment or enforcement rests upon a contingency, the agreement is valid even though it provides for a return in excess

of the legal rate of interest." *Prof'l Merch. Advance Capital, LLC v. Your Trading Room, LLC*, N.Y. Slip Op. 33785(U) (Sup. Ct. Suffolk Co. Nov. 28, 2012). A transaction "is not usurious merely because there is a possibility that the lender will receive more than the legal rate of interest." *Lehman v. Roseanne Investors Corp.*, 106 A.D.2d 617, 618 (2d Dep't 1984).

The First Department took up the issue of usury in the litigation funding context in *Cash4Cases, Inc. v. Brunetti*, 167 A.D.3d 448 (1st Dep't 2018). Cash4Cases, Inc. ("C4C") purchased the potential proceeds from Brunetti's personal injury case for $76,930.00. The case settled a short while later and after Brunetti failed to honor his agreement, C4C obtained judgment. The First Department held that the litigation funding agreement was neither usurious nor unconscionable:

> Assignment agreements such as the agreement at issue here are not loans, because the repayment of principal is entirely contingent on the success of the underlying lawsuit (*see id.; Matter of Lynx Strategies, LLC v. Ferreira,* 28 Misc. 3d 1205(A), 2010 N.Y. Slip Op. 51159(U]) (Sup. Ct., N.Y. Co. 2010); *Kelly, Grossman & Flanagan, LLP v. Quick Cash, Inc.,* 35 Misc.3d 1205(A), 2012 N.Y. Slip Op. 50560(U) (Sup. Ct., Suffolk Co. 2012); *Lawsuit Funding, LLC v. Lessoff*, 2013 N.Y. Slip Op. 33066(U) (Sup. Ct., N.Y. Co. 2013).

Cash4Cases, Inc., 167 A.D.3d at 449.

The First Department's citation to multiple trial court decisions reflects the consensus of the lower courts that *Echeverria v. Lindner*, 7 Misc. 3d 1019(A) (Sup. Ct. Nassau Co. 2005), the case cited by the Ninth Circuit, is not good law.

Kelly, Grossman Flanagan, LLP v. Quick Cash, Inc., 35 Misc. 3d 1205(A) (Sup. Ct. Suffolk Co. 2012), is especially instructive. The issue there was almost identical to that before this Court. The plaintiff law firms in *Kelly* entered into multiple contracts assigning their attorneys' fees in at least 27 cases to litigation finance companies, in exchange for more than $1,215,661.13 at a rate of more than 40% per annum. As here, the attorneys who received the funds argued that, due to large number of cases, these "loans were never non-recourse loans, despite the 'label', because the Defendants were not at risk." 35 Misc. 3d 1205(A), at *1. The *Kelly* Court rejected that argument and ruled:

> The concept of usury applies to loans, which are typically paid at a fixed or variable rate over a term. The instant transaction, by contrast, is an ownership interest in proceeds for a claim, contingent on the actual existence of any proceeds. Had respondents been unsuccessful in negotiating a settlement or winning a judgment, petitioner would have no contractual right to payment. Thus, usury does not apply to the instant case.

Id. at *6.

The *Kelly* Court recognized that, regardless of the numerosity of the civil actions encompassed by the investment, there was still risk to the funder because each case carried a genuine risk of no recovery.

Lower courts have also recognized that the timing of the funding relative to the case is not determinative. In *Sette v. Appleby,* 8 Misc.3d 1006(A) (N.Y. Civil Ct. 2005), for example, the Court upheld a financing agreement entered into after the plaintiff received a liability verdict but before a damages award.

All of these decisions recognize the many risks faced by a litigation funder who purchases an interest in a case, including the level of success (if any) that plaintiff may achieve, the timing of any award, the possibility of appeal, and whether defendant will have the means to pay. In litigation funding, all of these risks are enhanced since the funding company has neither control nor influence over litigation tactics, strategy or decision-making.

The Ninth Circuit singled out *Echeverria v. Lindner,* 7 Misc. 3d 1019(A) (Sup. Ct. Nassau Co. 2005), as a possible basis for a determination that litigation funding may qualify as a "loan" under New York law. In *Echeverria*, the trial court concluded that there "was a very low probability that judgment would not be in favor of the plaintiff … [because it] is a strict liability labor law case where the plaintiff is almost guaranteed to recover. There is low, if any risk." *Id*. at *8. The trial court held that the litigation funding was "a 'sure thing,' therefore it is a loan, not an investment with great risk." *Id.* at *8.

The analysis in *Echeverria* is flawed and its holding is contrary to New York law.[4] The trial court's analysis in *Echeverria*—dividing investments into "gambles," which it considered unlawful, and "sure things," which it deemed loans—would render much of the investment world subject to usury on a hindsight analysis. 7 Misc. 3d 1019(A) at *8. No other court has adopted such an analysis.

Echeverria's core premise—that there is little or no risk in a strict liability labor law case—is refuted by this Court's decision in *Blake v. Neighborhood Housing Services of New York City, Inc.,* 1 N.Y.3d 280 (2003). There, the Court observed, "we note that the words strict or absolute liability do not appear in Labor Law § 240(1) or any of its predecessors. Indeed, it was the Court—and not the Legislature—that began to use this terminology in 1923 (under an earlier version of the statute [*see* L. 1921, ch. 50])." *Blake*, 1 N.Y.3d. at 286-87. The *Blake* Court

[4] *Echeverria* should be rejected on procedural grounds as well. The litigation finance company, Funding Corp. d/b/a LawCash ("LawCash"), was not a party to the *Echeverria* case and the trial court issued an improper advisory opinion on its rights. The issue of the allegedly "usurious" LawCash contract arose *sua sponte* during a simple inquest. As a result, there was no "justiciable controversy" involving LawCash pending before the court. *See Chanos v. MADAC,* 74 A.D.3d 1007 (2d Dep't 2010) (citing *Veau v. Braisted,* 5 A.D.2d 603 (2d Dep't 1958)), *aff'd*, 5 N.Y.2d 236, *aff'd*, 363 U.S. 144 (1960); *Playtogs Factory Outlet v. County of Orange,* 51 A.D.2d 772 (2d Dep't 1976). Because LawCash was not before the court to challenge the assertions of Echeverria, the decision is of no probative value. *Kirkland v. Annucci,* 150 A.D.3d 736 (2d Dep't 2017).

After the *Echeverria* decision, LawCash, in accordance with the contractual venue clause, filed a complaint against Echeverria for a declaratory judgment in the Supreme Court of New York, Kings County, *Plaintiff Funding Corp. d/b/a "Law Cash" v. Juan V. Echeverria,* Index No.: 10140/2005, seeking to declare the LawCash funding agreement lawful. After Echeverria defaulted, on July 8, 2005, the Honorable Gerard H. Rosenberg, J.S.C. issued an order granting declaratory relief to LawCash.

went on to say that use of the word "absolute" means only that "owners or contractors not actually involved in construction can be held liable, regardless of whether they exercise supervision or control over the work." S*ee Blake,* 7 N.Y.3d. at 287 (citations ommitted). The *Blake* Court recognized that an accident alone does not establish either a Labor Law 240(1) violation or causation of injury. Court have repeatedly ruled that "strict" or "absolute" liability is necessarily contingent on a violation of Section 240(1). *Accord Melber v. 6333 Main St.,* 91 N.Y.2d 759, 762 (1998) ("the statute establishes absolute liability for a breach which proximately causes an injury"); *Zimmer v. Performing Arts,* 65 N.Y.2d 513, 522 (1985); *Duda v. Rouse Constr. Corp.,* 32 N.Y.2d 405, 410 (1973) ("plaintiff was obligated to show that the violation [of Section 240(1)] was a contributing cause of his fall"). In *Duda*, the trial court dismissed the case at the close of plaintiff's proof, finding that the defendant was outside the scope of Labor Law 240. *Duda* 32 N.Y. 2d at 408. This Court affirmed. *Id*. at 410.

What is made clear by *Blake*, *Duda* and similar cases, is that, even when a plaintiff asserts a claim under a "strict liability" statute, such as Labor Law 240, litigation risk is present. The plaintiff must establish that he/she qualifies under the statute, that the defendant falls within its scope, that the violation caused the injury, and plaintiff must then quantify the loss. Additional risk is also associated with

collecting on any judgment. These cases well illustrate the fallacy of the *Echeverria* holding.

The contention that "likelihood" should replace "certainty" to determine usury under G.O.L. 5-501 and Penal Law 190.40 would have far reaching implications to financial transactions in New York where businesses seeking capital offer high returns in exchange for significant risks.

For example, lenders may agree to make a loan to a corporation at a lawful rate of interest, while receiving stock options or the right to convert the loan to shares of stock. Each of these rights may have no actual value at the time of the loan.[5] Those rights may later produce returns well in excess of 25% per annum. New York courts have unanimously ruled that the uncertain and contingent nature of stock options and conversion rights precludes their consideration in any usury analysis. *LG Capital Funding, LLC v. Sanomedics Int'l. Holdings, Inc.*, 2015 N.Y. Slip Op. 32232(U) (Sup. Ct., Kings Co. Nov. 23, 2015) ("upon conversion at Plaintiff's election [Defendant's] debt to plaintiff [would] become an investment, upon which plaintiff took the risk that the stock could become completely worthless."); *Union Capital, LLC v. Vape Holdings Inc.*, 2017 WL 1406278, at *8 (S.D.N.Y. Mar. 31, 2017) ("even if [Plaintiff] chose to convert the loan principal

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[5] The equity rights would have no value if the options were out of the money, i.e. the shares were worth less than the exercise or conversion price.

into shares, any potential profit [Plaintiff] might realize would still be dependent on the market price at the time of conversion and so, therefore, would be too uncertain to incorporate into an interest rate calculation"); *Beaufort Capital Partners, LLC v. Oxysure Sys.*, 2017 WL 913791, at *4 (S.D.N.Y. Mar. 7, 2017); *LG Capital Funding, LLC v. 5Barz International, Inc.*, 307 F. Supp. 3d 84, 98 (E.D.N.Y. 2018).

This precedent derives from this Court's analysis in *Halsey v. Winant*, 258 N.Y. 512, 526 (1932), where the Court held, "[T]he price at which a person takes an option, especially under circumstances where he is involved in a highly speculative transaction … is no reliable criterion of value" and that "[i]n taking the stock, … defendant … took all the risks, and to say under those circumstances that the price which it paid was unfair consideration seems to be an improper conclusion."

Accounts receivable financing is another type of transaction that would be affected by Sax's hindsight analysis. Many finance companies purchase future accounts receivable from merchants, with the value of the future accounts receivable providing a return, if paid in full, in excess of 25%. Courts have ruled that the transactions are neither loans, nor disguised loans, recognizing that the finance company is subject to the risk that the merchant may not generate future receivables. *See, e.g.*, *K9 Bytes, Inc. v. Arch Capital Funding, LLC*, 56 Misc. 3d

807 (Sup. Ct. Westchester Co. 2017); *Pirs Capital, LLC v. D & M Truck, Tire & Trailer Repair Inc*., 69 Misc. 3d 457 (Sup. Ct. N.Y. Co. 2020); *Wilkinson Floor Covering, Inc. v. Cap Call, LLC*, 59 Misc. 3d 1226 (A) (Sup. Ct. N.Y. Co. 2018); *LG Funding, LLC v. United Senior Properties of Olathe, LLC*, 181 A.D.3d 664 (2d Dep't 2020).

The opinion in *Transmedia Restaurant, Inc. v. 33 E. 61st Street Restaurant Corp*, 184 Misc. 2d 706 (Sup. Ct. N.Y. Co. 2000), underscores the many forms that investments seeking higher returns may take. In *Transmedia*, the finance company advanced $60,000 to the defendant restaurant, receiving food credits with a face value of $120,000. The finance company issued "Transmedia" cards to its customers who could redeem the credits by dining at the restaurant. The restaurant offered discounted meals to the cardholders and paid Transmedia as the credits were redeemed. Since this was the only means of repayment, "Transmedia bears the risk of not being repaid the advanced funds." 184 Misc. 2d at 711. The advance was therefore not a loan. *Id.*

Here, at all stages of this case, Sax has failed to establish, by any evidence, that he received a loan. Before the District Court, Sax argued that Fast Trak could recover monies from a "lengthy list of secondary" cases as "backup collateral" in order to collect on its investment if the Primary Cases did not realize sufficient proceeds. (R. 29) Nowhere in his submission to the District Court did Sax offer

evidentiary support for his claim that the Secondary Cases were risk free, either individually or as a group. Sax surely falls far short of the "clear and convincing evidence" required by New York law.

In his brief to this Court, Sax argues that the "relevant factual issue on remand would be whether the occurrence of the triggering condition (i.e., Sax's success in his cases) was sufficiently certain so as to constitute a 'loan' or a 'cover for usury.'" (Appellant's Br., p. 14) Sax seriously misstates New York law. Sax would have to show that success in his cases was certain at the time of the advance, that the certainty was known by Fast Trak, and that the certainty would produce an excessive rate of return. As a matter of law, no such showing is made simply by presenting a list of cases and, with the benefit of hindsight, showing a return in excess of 16%.

A review of the Secondary Cases underscores the flaws in Sax's theory. Fast Trak's return was generated, in large part, by the outcomes in two cases *Gallow v. Rest* ($79,800) and *Alexander v. Geico, Inc.* ($66,207). (See Decl. of Jamie Burke, PACER Dkt. No. 75-1, Ex. 1 (July 3, 2018).) How could Sax or Fast Trak have known that those cases would produce those results a year or more later? Sax's Affidavit in Opposition to Summary Judgment makes no such claim; nor does he offer any evidence to suggest that Fast Trak did not assume genuine risk with the limited number of cases covered by the Secondary Agreements. (R. 416-421) Sax's

claim of usury based solely on an after-the-fact tally is contrary to New York law and must be rejected.

The Ninth Circuit misapprehends the nature of the Fast Trak Agreements when it lays out the schedule of payments in the *Gadow* agreement and re-casts them as "annual compounded interest." 962 F.3d at 464. The payments were never owed until the case resolved in Gadow's favor. The amounts represented the most that Fast Trak could receive, assuming a positive outcome in the case. Had Fast Trak taken a percentage interest in the recovery – an investment that all would recognize as different from a loan – it might well have received more.[6]

Sax also contends that "Plaintiff's loan was secured by other cases, so that unless I lost each and every case, Plaintiff still had the right to collect from the 'Secondary Cases.' To lose each and every case would be highly unlikely." (R. 420 ¶ 14) In other words, Sax suggests, success in one case assured Fast Trak of payment in full; with 12 cases, payment was even more certain. This too is false. Sax lost many cases and had modest fees on the vast majority. He proved successful in two cases, and those fees generated the returns he now claims usurious. The list of Secondary Cases did nothing more than improve Fast Trak's

[6] There is a second error in the Ninth Circuit's focus on *Gadow*. The Fast Trak investments were made as a package in March 2013. While each contract stood by itself, Fast Trak would not have advanced funds absent the complete set of agreements.

prospects for a return, without rendering the amount (or timing) of that return either an actual or virtual guarantee.

The Court, moreover, should resist Sax's invitation to issue an advisory opinion that rests on hypothetical scenarios not presented by the present record. *Hearst Corp. v. Clyne,* 50 N.Y.2d 707, 713 (1980) ("Courts are generally prohibited from issuing advisory opinions or ruling on hypothetical inquiry"). Sax plays fast and loose with the facts in an effort to persuade the Court to address a case different from the one now before it. The limited list of Secondary Cases did not, on their face, assure Fast Trak of any specific recovery, much less one that was unlawful. The Agreements were structured for Sax's benefit, so that he could obtain immediate funds in exchange for the possibility that he might pay far larger amounts based on the results in a handful of civil actions where Sax served as counsel.

Sax contends, to comply with the Agreements, "I would have been put out of business. Plaintiff's contract seems impossible to comply with without being driven into bankruptcy." (R. 418 ¶ 10) This is both untrue and irrelevant. All new cases originated by Sax were his exclusively, as were any other matters which he retained separate from the Secondary Cases. Sax's problems result from the negative outcomes in the Secondary Cases, which affected Sax as much as Fast Trak, and his inability to obtain new clients who could provide his law firm with

revenue. In fact, Sax attributes his alleged dire financial straits to the "great Recession." (R. 417 ¶ 7)

This Court should not credit Sax's groundless assertion that the Secondary Cases provided certainty to Fast Trak. To do so, would render every risky investment subject to collateral attack based on the proposition that the favorable outcome was known all along; in each instance the collateral attack would be advanced by a party that has received funds and then invokes "usury" in a bid to obtain a windfall. Indeed, this is precisely the tactic Sax has employed here. Having taken Fast Trak's money to pay off another litigation funder and to keep his law firm operational, Sax now seeks to keep it all. New York's usury laws were never intended for such abuse.

C. A Litigation Funding Arrangement with a Possible Recovery from Legal Fees in Additional Cases Is Not a "Cover for Usury"

The term "cover for usury" has long been used by New York courts to describe loans or interest disguised to conceal their true nature. *E.g., Sumner v. People*, 29 N.Y. 337 (1864); *Clarke v. Sheehan*, 47 N.Y. 188 (1872). The doctrine is as old as usury itself and stands for the proposition that substance prevails over form. Under New York law, "it is the economic substance of a transaction that should determine the rights and obligations of interested parties" not the labels that they have applied. *Sumitomo Mitsui Banking Corp. v. Credit Suisse*, 89 A.D.3d 561, 564 (1st Dep't 2011) (question of fact whether economic substance of transaction effected cash

repayment or reallocation of debt); *Berliner Handels-und Frankfurter Bank, N.Y. Branch v. Coppola*, 172 A.D.2d 369, 372 (1st Dep't 1991) (a question of fact whether loan was made by bank outside of U.S. or, made domestically).

So too with lending arrangements to which the parties have applied a different name.

In *Leavitt v. DeLauny*, 4 N.Y. 363 (1850), the Court explained, "It is not denied that a sale or exchange, in form, may be adopted as a cloak for a usurious loan. But the party impeaching an agreement on this ground, must, by evidence, remove the covering from the transaction, and exhibit it as a loan of money." 4 N.Y. at 374. The analysis in *Quackenbos v. Sayer*, 17 Sickels 344 (1875), establishes the relevant standard. There, the borrower was in desperate need of cash but the lender indicated that it could only sell railway bonds, which were offered at an artificial value; the borrower took the bonds, selling them immediately to raise cash while remaining personally liable for the inflated purchase price. In finding that the loan was made on disguised usurious terms, the Court articulated that "[t]ransaction must be judged by its real character, rather than by the form and color which the parties have seen fit to give it." *Id*. at 346. As the Court's commentary makes clear, the structure was forced upon a desperate borrower with an artificial value to disguise the loan.

In *Orvis v. Curtiss*, 157 N.Y. 657 (1899), the Court declined to apply the doctrine where "there is no proof in the record of any preliminary negotiation to show that the agreement was not intended for the purpose intended upon its face, but as a mere device or subterfuge to conceal a loan of money." 157 N.Y. at 660. The Court added, "There must exist, in fact, or in law, a corrupt purpose or intent on the part of the person who takes the security to secure an illegal rate of interest for the loan or forbearance of money." *Id.* at 661. *See Seidel v. 18 East 17th Street Owners, Inc.*, 79 N.Y.2d 735, 744 (1992) (transaction labeled a "loan" treated as such instead of "joint venture").

A "loan" for the purposes of the cover for usury doctrine is the same as one within the meaning of G.O.L. 5-501 and Penal Law 190.40. In this case, Sax would be required to show that he wanted to borrow money, that Fast Trak intended the purchase of litigation interests as a loan, and that the characterization of the transaction was intended to disguise a loan. Nothing in the record provides support for such a claim. Fast Trak is an established litigation funder, offering a single product: the purchase of interests in pending cases or attorney's fees generated by pending cases. Sax neither sought, nor was offered, a loan under which Fast Trak might have recourse against him personally. The cover for usury theory fails based on the absence of evidence that Fast Trak sought to disguise the transaction in any manner.

The same factors that demonstrate the Primary and Secondary Agreements were not "loans" also confirm that they are not a "cover for usury." The fact that each Agreement looked solely to the outcome of a litigation, and was without personal recourse, makes clear that Fast Trak had no assurance that its investment capital would be repaid, or that it would receive a return on its investment at any specific level.

Any "cover for usury" claims also fails for want of any evidence of deceit. The litigation funding agreement has minimal connections to New York. Fast Trak is a Delaware company that then had offices in the Bronx; Sax is a member of the California bar who sought the funds for his law practice in Santa Rosa, California. Fast Trak agreed that New York law would govern, a decision that is irreconcilable with any scheme to evade the usury laws. (R. 78) The undisputed record confirms Fast Trak's good faith.

The "cover for usury" doctrine, moreover, must have rare application in the commercial context. Distressed and start-up businesses are often unable to obtain funding from a bank or other traditional source of capital. These businesses offer investors the possibility of returns in excess of 25% per annum for the simple reason that the market requires it. Investors in these enterprises may structure their transactions to eliminate deal terms that require certainty of payment, so that the financing does not qualify as a "loan" under New York law. These structures

benefit the recipient of capital because they either make the transaction non-recourse or provide for payment out of profits (if any) or with shares of stock (if those have any value). Any effort to recast these commercial transactions under the "cover for usury" doctrine would provide the recipients of funding with a windfall at the expense of funders who took care to comply with established precedent. These considerations apply fully to Sax, who sought funds for his law practice while assuring his personal assets were not in jeopardy.

D. Sax Has Waived the Usury Defense

The Ninth Circuit indicated that this Court may consider any issues it deems relevant. We submit that the Court may also address whether Sax has waived the right to raise usury as a defense. In paragraph 4 of each Secondary Agreement, Sax agreed to a waiver of defenses, which stated:

> SAX hereby waives any and all defenses to the enforcement of this Agreement and the Exhibits and specifically and unconditionally waives any claims that the attorneys fees and disbursements are not assignable or that any other provision of this Agreement and the Exhibits is invalid or unenforceable in any respect. Further, SAX agrees that both Fast Trak and SAX participated in the drafting of this agreement."

(R. 78; 90; 123; 140 and 156)

A broadly worded general waiver provision in a note is effective to bar the assertion of defenses on the note (*see e.g. Citibank v. Plapinger,* 66 N.Y.2d 90, 495 (1985)), except where precluded by considerations of public policy (*see e.g. Red*

Tulip, LLC v. Neiva, 44 A.D.3d 204, 209–210 (2007)). The long-standing rule in New York is that civil usury is a waivable defense (*see Billington v. Wagoner,* 33 N.Y. 31, 33–34 (1865); *see also Hammelburger v. Foursome Inn Corp.,* 76 A.D.2d 646 (1980), *mod and aff'd. on other grounds,* 54 N.Y.2d 580 (1981); *Howard v. Kirkpatrick,* 263 A.D. 776 (3d Dep't 1941), and where the defense of usury has been waived, defendants have thereafter been precluded from raising it as a defense (*see Le Vine v. Flynn,* 231 A.D.2d 555 (2d Dep't 1996); *see also Central Funding Co. v. Deglin,* 67 A.D.2d 673, 674 (2d Dep't 1979), *aff'd.* 48 N.Y.2d 964 (1979)). As an attorney, Sax surely understood this waiver.

The Court should presume that Sax, as an attorney, understood the alleged nature of the transaction, knowingly made such a waiver, and should not be permitted to later challenge its terms *Angelo v. Brenner*, 90 A.D. 131 (3d Dep't 1982).

V. SECOND QUESTION PRESENTED

2. *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?*

The second certified question asks this Court to examine the appropriate consequences, if any, "for the obligor to the party who financed the litigation, under agreements that are so qualified?" If the Court determines that Fast Trak has

not made a loan under G.O.L. 5-501 or Penal Law 190.40, there is no need to address this question. If the Court determines that the agreements may, in fact, be loans, then this Court must guide the Ninth Circuit in determining the consequences to Sax.

According to Sax, the answer is simple: He keeps everything. In his Opening Brief, Sax posits that, "If the Contracts Constitute Loans, They Are Usurious and Void, and Interest and Principal Are Cancelled." (Sax Brief, pages 15-16) Sax supports his position by quoting, verbatim, from the Ninth Circuit's Certification Order. (Sax Brief, pages 16-38)

Fast Trak requests that the Court answer the second question in a manner that would give trial court's discretion to permit Fast Trak to recover the amount invested plus an appropriate return.

Section 5-511 of the G.O.L. provides that a loan in violation of the statute "shall be void." Litigants have seized on this language to contend that such a loan, or one in violation of Penal Law 190.40, is unenforceable in all respects. The borrower, they contend, may retain the lender's principal. The prospect of such a windfall has attracted significant litigation from parties far removed from the intended purpose of the usury laws, which "from time immemorial, has been to protect desperately poor *people* from the consequences of their own desperation." *Schneider v. Phelps*, 41 N.Y.2d 238, 243 (1977) (emphasis added). This Court's

discussion of the legislative history involving the extension of usury laws to corporations makes clear that, even there, the legislature intended to protect natural persons. *Hammelburger v. Foursome Inn Corp.,* 54 N.Y.2d 580, 589 (1981) (observing that corporations are covered by usury laws because loan sharks had required individuals to borrow in corporate form to evade the statute).

The two certified question cases now before this Court present examples of how sophisticated litigants seek to game the usury defense. Genesys ID, Inc. ("Genesys"), Defendant-Appellant in CTQ 2020-00005, is a publicly listed company that borrowed funds, advised by lawyers and bankers. The Court may presume that its directors fulfilled their fiduciary obligations and obtained the most favorable terms available. Genesys now seeks to keep the lender's principal on the theory that it is the "victim" of a usurious loan because the lender accepted payment in shares of stock in lieu of cash, potentially receiving high returns if buyers for those shares could be located. Defendant-Appellant Richard Sax is a seasoned trial lawyer who induced Fast Trak to enter into litigation funding agreements by representing that his net worth exceeded $2 million. He too has taken the position that he can retain the money that he received. The vast majority of reported decisions involving the usury laws in recent years have involved commercial borrowers, many in the high-risk microcap space, and all without access to traditional sources of credit. The recurring fact pattern in these decisions

involves a putative borrower that has received funds in a commercial setting and later invokes usury to avoid payment on the investor's capital.[7]

The District Court's decision in *EMA Financial LLC v. NFusz, Inc.,* 444 F. Supp.3d 530 (S.D.N.Y. 2020), provides another example of the lengths that borrowers will go to obtain an advantage from New York's usury laws. There, a Nevada corporation borrowed money under an agreement governed by Nevada law; it nonetheless argued that the lender's presence in New York made the loan void as against New York public policy. The District Court ruled that New York's usury laws did not represent a fundamental policy that would prevent a New York court from enforcing a Nevada choice of law clause where the borrower had substantial contacts with that forum. *Id.* at 543.

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[7] *Microcap Financing: E.g,, LG Capital Funding, LLC v. PositiveID Corp*., 2019 WL 3437973 (E.D.N.Y. July 29, 2019), *report and recommendation adopted*, 2019 WL 4564882 (E.D.N.Y. Sept. 20, 2019); *EMA Financial, LLC v. AIM Exploration, Inc*., 2019 WL 689237 (S.D.N.Y. Feb. 19, 2019); *Blue Citi, LLC v. 5Barz International, Inc*. 338 F. Supp.3d 326 (S.D.N.Y.2018); *Adar Bays, LLC v. Aim Exploration, Inc*., 285 F. Supp. 3d 698 (S.D.N.Y. 2018); *Am. E. Grp., LLC v. Livewire Ergrogenics, Inc*., 2018 WL 5447541 (S.D.N.Y. Oct. 29, 2018); *Adar Bays, LLC v. Genesys ID, Inc*., 341 F. Supp.2d 339 (S.D.N.Y. 2018); *Vis Vires Grp., Inc. v. Endonovo Therapeutics, Inc*., 149 F.Supp.3d 376 (E.D.N.Y. 2017); *Union Capital, LLC v. Vape Holdings Inc.*, 2017 WL 1406278 (S.D.N.Y. Mar. 31, 2017); *Beaufort Capital Partners, LLC v. Oxysure Sys.*, 2017 WL 913791 (S.D.N.Y. Mar. 7, 2017); *LG Capital Funding, LLC v. Sanomedics Int'l Holdings, Inc.*, 2015 WL 7429581 (Sup. Ct. Kings Co. Nov. 23, 2015); *Anstalt v. Biometrix Inc.*, 2010 NY Slip Op 30045 (Sup. Ct. Suffolk Co. Jan. 6, 2010).

Accounts Receivable Financing: E.g., LG Funding LLC v. United Senior Properties of Olathe, LLC, 181 A.D.3d 664 (2d Dep't 2020); *Champion Auto Sales, LLC et al. v. Pearl Beta Funding, LLC*, 159 A.D.3d 507 (1st Dep't 2018); *Pirs Capital, LLC v. D & M Truck, Tire & Trailer Repair Inc*., 69 Misc.3d 457 (Sup. Ct. N.Y. Co. 2020); *Wilkinson Floor Covering, Inc. v. Cap Call, LLC*, 59 Misc. 3d 1226(A)(Sup. Ct. N.Y. Co. 2018); *Yellowstone Capital LLC v. Central USA Wireless LLC*, 50 Misc.3d 1220 (Sup. Ct. Erie Co. 2018)(collecting 38 cases); *K9 Bytes, Inc. v. Arch Capital Funding, LLC*, 56 Misc. 3d 807 (Sup. Ct. Westchester Co. 2017).

This Court's rulings have not provided a detailed analysis of G.O.L. 5-511 or its interplay with Penal Law 190.40, although the Court has generally indicated that a loan that is usurious on its face may lead to dire consequences. In *Seidel v. 18 East 17th St. Owners, Inc.*, 79 N.Y.2d 735, 740 (1992), the Court remarked, "The consequences to the lender of a usurious transaction can be harsh: the borrower is relieved of all further payment…" But the Court in *Seidel* also observed that the lender "would be entitled, at most, to recovery of the amount advanced, with legal interest…" *Id.* at 743 (citing *Hammelburger v. Foursome Inn Corp.*, 54 N.Y.2d 580, 588 (1981); *Claflin v. Boorum*, 122 N.Y. 385, 389 (1890); and *Payne v. Burnham*, 62 N.Y. 69, 74 (1875)). The Court noted the lender had already recovered its principal and denied any further recovery on a mortgage loan made at a usurious interest rate. In *Giventer v. Arnow*, 37 N.Y.2d 305, 309 (1975), the Court reviewed a primary note that "establish[ed], on its face, clear evidence of usury" and affirmed dismissal of the lender's suit to enforce the note. *See Szerdahelyi v. Harris*, 67 N.Y.2d 42, 51 (1986) (lender may retain lawful interest but "cannot recover either the money loaned or the interest remaining due in this transaction.").

The absence of detailed analysis of the remedies under New York's usury laws is underscored by *In re Venture Mortgage Fund, L.P.*, 282 F.3d 185 (2d Cir. 2002). In that case, the Circuit Court reviewed a Ponzi scheme in which the

borrower lured investors with a promise of interest at 27 percent per annum. The scheme was accompanied by claims of investing in fictitious "low risk" mortgage pools. When the scheme unraveled, the borrower filed for bankruptcy and its principal plead guilty to wire fraud. The victims sought to recover in the bankruptcy, but the trustee objected on the grounds that their loans were usurious. The Circuit Court affirmed dismissal of the victims' claims, which had been asserted on an estoppel theory. The Court noted that the victims had conceded that, absent estoppel, their loans would be "void" and they would be without recourse. The Court's remarks suggest that absent that concession, it was prepared to consider whether the victims of a Ponzi scheme should be punished by forfeiture of their principal. The Circuit Court also flagged an unresolved issue under New York's usury law: whether a loan is void if it violates New York's criminal usury statute without violating New York's civil usury statute. The Court's discussion identifies reasons why such a loan would not be void. The Court referenced a loan in excess of $250,000 as one such transaction:

> On the one hand, it may be expected (as the parties to this appeal evidently assume) that one who commits criminal usury should not be preferred (and be able to collect) over the usurer who charges a rate of interest that is not criminal. On the other hand, the larger the loan transaction, the less likely it is that the borrower needs or deserves financial protection; moreover, the greater the amount of forfeiture, the more unsettling it becomes to financial arrangements.

Id. at 189; *see also Funding Group, Inc. v. Water Chef, Inc.*, 19 Misc. 3d 483 (Sup. Ct. N.Y. Co. 2008).

The word "void" in Section 5-511 rests at the crux of the second certified question. While litigants anxious to avoid repayment have focused on its draconian implications, the term is used throughout Article 5 of the General Obligations Law to apply to a range of transactions that the Legislature has determined should not be enforced in the Courts. The determination reflects a policy judgment, but not necessarily a determination that the contract is immoral or that the party who seeks to benefit from the prohibited term is an evildoer.

Section 5-701 embodies New York's statute of frauds. It provides that any "agreement, promise or undertaking" covered by subparts (1) through (10) is "void." New York courts have recognized that a valid written agreement is not rendered "void" simply because a party claims to have additional oral covenants or understandings. *See Apostolos v. R.D.T. Brokerage Corp.*, 159 A.D.2d 62, 65-66 (1st Dep't 1990) ("where an oral agreement is a severable one, *i.e.*, susceptible of division and apportionment, having two or more parts not necessarily dependent upon each other, that part which, if standing alone, is not required to be in writing, may be enforced..."); *Cohen v. Trump Organization LLC*, 2019 NY Slip Op 32565, at *21 (Sup. Ct. N.Y. Co. Aug. 28, 2019) (finding oral agreement to pay legal fees in future matters void under Statute of Frauds, however, stating that "it is

appropriate to sever the Agreement so as to permit enforcement of the alleged oral agreement to pay Cohen's legal fees and costs for the Pending Matters"). No Court would prohibit enforcement of a valid written agreement based solely on a claim that the parties also had oral agreements that were void under G.O.L. 5-701.

Nor has the prospect of an unenforceable oral agreement raised moral concerns. "[A]s a practical matter, a contract not drawn in accordance with the Statute of Frauds is not ipso facto void but only voidable, subject to being declared void if and when the statute is interposed as a defense 'at the proper time and in the proper way.'" *Felicie, Inc. v. Leibovitz*, 67 A.D.2d 656, 657 (1st Dep't 1979). New York courts have also recognized that promissory estoppel may be appropriate to prevent an inequitable outcome where a party has relied upon an oral promise that would otherwise be "void" under G.O.L. 5-701. *In re Estate of Hennel,* 29 N.Y.3d 487, 494 (2017) ("where the elements of promissory estoppel are established, and the injury to the party who acted in reliance on the oral promise is so great that enforcement of the statute of frauds would be unconscionable, the promisor should be estopped from reliance on the statute of frauds").

The term "void" is also applied in the G.O.L. to contractual provisions that the Legislature has deemed contrary to public policy, such as a covenant exempting a lessor from negligence (5-321); a release by a user of recreational facilities (5-326); and agreements prohibiting certain parties from expressing

opinions about a contracting party (5-337). No one would suggest that a tenant is excused from paying rent simply because its lease includes a clause exempting the lessor from claims of negligence.

It is fundamental that "Statutes that relate to the same subject are in pari materia" and should "be construed together unless a contrary intent is clearly expressed by the Legislature." *Albany Law Sch. v. New York State Office of Mental Retardation & Developmental Disabilities*, 19 N.Y.3d 106, 121 (2012); *People v. Wallace*, 31 N.Y.3d 503, 509 (2018) (same); *Plato's Cave Corp. v. State Liquor Auth.*, 68 N.Y.2d 791, 793 (1986) (same); *Chemung v. Shah*, 28 N.Y.3d 244, 262 (2016) ("statutes relating to the same subject matter ... must be read together and applied harmoniously and consistently").

For this reason, the term "void" in G.O.L. 5-511 should be construed in a manner consistent with its usage in other parts of the General Obligations Law. The trial court should be permitted to consider a variety of factors in fashioning a remedy, including whether the investment was in a form different from a traditional promissory note, the sophistication of the parties and their good faith. Indeed, there are multiple cases from the lower courts that have applied these or similar concepts to avoid the draconian outcome that Sax advocates.

In *Pisano v. Rand,* 30 A.D.2d 173, 176 (2d Dep't 1968), the Court noted that:

> while full effect should be given to the statutes against usury, their penalties are not to be extended to situations not within their primary intendment, especially in circumstances which would preserve the borrower's ownership of the security and at the same time confer upon him the benefit of an unjust enrichment.

See, e.g., Patterson v. Birdsall, 64 N.Y. 294, 297–98 (1876); *Hawkins v. Maxwell*, 156 A.D. 31, 34 (2d Dep't 1913), *aff'd*, 215 N.Y. 673 (1915); *New York Public Lib. v. Tilden*, 39 Misc. 169, 183 (1902); *Diamond v. Tau Holding Corp.*, 131 Misc. 446, 451 (Sup. Ct. N.Y. Co. 1927); *Catskill Nat. Bank & Trust Co. v. Saxe*, 175 Misc. 501, 503–504 (Sup. Ct. Green Co. 1940).

If the agreements are declared "void," we submit, this Court may determine among a range of possible consequences, based on "the specific facts given to this Court" on the Certified Question. *See Engel v. CBS, Inc.,* 93 N.Y.2d 195, 199 (1999). These consequences include:

1) Sax must return to Fast Trak the "principal" plus the contractual "return on its investment" (in this case, $315,600 in the Order Awarding Damages);
2) Sax must pay Fast Trak the amount invested plus legal interest, i.e., 16 percent per annum; or
3) Sax must pay Fast Trak the amount invested.

The basis for requiring Sax to pay the "principal" plus the contractual return on its investment arises from the fact that Sax was a fiduciary to Fast Trak. "A

borrower, who, because of a fiduciary or other like relationship of trust with the lender, is under a duty to speak and who fails to disclose the illegality of the rate of interest, is estopped from asserting the defense of usury where the lender rightfully relies upon the borrower in making the loan." *Abramovitz v. Kew Realty Equities, Inc.,* 180 A.D.2d 568, 568 (1st Dep't 1992). In *Abramovitz*, "the individual defendants, both experienced and sophisticated businessmen licensed to practice law in New York, induced plaintiff to advance them $650,000 to further their real estate interests, by taking advantage of plaintiff's long-standing friendship and trust in his attorney, Mordowitz, and by promising him a "profit" and "fee" on his investment; Mordowitz then drafted the original documents and set the financial terms that defendants later claimed are usurious; and although defendants were aware of the legal rate of interest when they drafted the documents and borrowed the money, they did not so advise the plaintiff, nor did they advise him to seek independent counsel." *Id.* As a result, the Appellate Division affirmed the judgment against the borrowers even though the interest rate was 25 percent.

The District Court awarded damages against Sax for breach of fiduciary duty. Sax was a fiduciary of Fast Trak through the original agreement dated January 2, 2013 between Myers Monigan and Fast Trak. (R. 10) Although an arm's length contractual relationship will not normally create fiduciary duties,

fiduciary duties may be voluntarily assumed by contract. *See, e.g., Ross v. FSG PrivatAir, Inc.*, 2004 WL 1837366, at *5 (S.D.N.Y. 2004).

The voluntary assumption of fiduciary duties was material to Fast Trak. Sax undertook this duty, and then took advantage of his role as a fiduciary of Fast Trak to obtain this financing. At the time that the parties entered into the agreements, neither party believed them usurious. Both parties acted in good faith. When it came time to pay Fast Trak, Sax decided that these agreements were usurious. Because Sax was significantly involved in the processing of the agreements and proposing the specific collateral for the amount funded, Sax took advantage of his fiduciary position, to the detriment of Fast Trak. *Abramovitz* suggests that, as a fiduciary, Sax should not be permitted to argue usury as a defense of the agreements.

A second outcome would permit Fast Trak to recover its investment plus interest to the extent permitted by law, 16 percent. The draconian results applied to a promissory note that is usurious on its face make no sense for complex commercial transactions where financial institutions provide capital to high risk business enterprises. Those transactions, by their terms, may or may not provide an excessive return, but the outcome can only be determined with hindsight. The advance of funds to an attorney and his law firm, with recourse solely against recoveries in a specific set of cases, is just such a transaction. If a Court were to

recharacterize these transactions as a "loan" under G.O.L. 5-501 or Penal Law 190.40, only the alleged illegal portion of the transaction should be deemed "void".

This outcome is comparable to severing an alleged oral agreement, which may be "void" under the statute of frauds, from a written transaction. *U.K. Cable Ventures, Inc. v. Bell Atl. Investments*, 232 A.D.2d 294, 294 (1st Dep't 1996); *Gold v. Benefit Plan Adm'rs, Inc.,* 233 A.D.2d 421, 423 (2d Dep't 1996); *Dickenson v. Dickenson Agency, Inc*., 127 A.D.2d 983, 984 (4th Dep't 1987).

If the Court were to permit Sax to pursue a claim that such a transaction is a loan, it would be appropriate to limit Sax's remedy to the portion of the transaction that might be unlawful. Such an outcome would be consistent with the intent behind the usury laws, namely to protect individuals, and with the Legislature's use of the term "void" in other portions of the General Obligations Law.

A third alternative would be to rescind the Agreements and restoring the parties to the *status quo ante*. The record demonstrates that neither Fast Trak nor Sax believed that the Agreements were illegal loans at the time that they signed them. (R. 56, R. 432) Mutual mistake renders a contract voidable. *City of Binghamton v. Serafini,* 8 A.D.3d 835, 838 (3d Dep't 2004); *Asset Management & Capital Co., Inc. v. Nugent,* 85 A.D.3d 947, 948 (2d Dep't 2011) ("For a party to be entitled to reformation of a contract on the ground of mutual mistake, the mutual mistake must be material, i.e., it must involve a fundamental assumption of

the contract”). As a result, the trial court may rescind the contracts and require Sax to pay Fast Trak the amount that he received.

Feldman v. Grant, 213 A.D.2d 340 (1st Dep’t 1995), is instructive. In *Feldman*, the parties were under the mistaken assumption that the corporate borrower was in legal existence. They later learned that the corporate borrower was never formed.

> We are satisfied that both the plaintiff-lender and the two individual defendants, Grant and Anderson, were acting in good faith under a mutual mistake as to the bona fide existence of New Horizons Realty, Inc., and intended that New Horizons be the borrower under the loan agreement. In the absence of a validly created corporate borrower, it is conceded that the defense of usury would bar enforcement of the loan agreement both as to principal and interest.

Id. at 341 (citing G.O.L. 5-511[2]; *Seidel v. 18 East 17th St. Owners,* 79 N.Y.2d 735 (1992)).

The Court in *Feldman* stated that this is not a situation where the corporate form was used to shield from usury a loan to an individual for personal debts as in *Schneider v. Phelps*, 41 N.Y.2d 238 (1977). The purpose of the loan was to purchase a building as an investment, a valid corporate undertaking.

In the present situation, the record is clear that Sax sought these funds to support his law practice. It is also clear that when the parties entered into the agreements, neither one viewed them as usurious loans. Should this Court

determine that Fast Trak made a loan under G.O.L 5-501, there was a mutual mistake. Under these limited circumstances, it would be inequitable to permit Sax to retain Fast Trak's capital.

VI. CONCLUSION

For the foregoing reasons, Respondent Fast Trak respectfully requests that the Court answer the first certified question in the negative and that it decline to answer the second question as unnecessary. In the event that the Court addresses the second question, we respectfully request that the Court advise the trial court that, based on the facts of this case, it may permit Fast Trak to recover in full if it finds that Sax was a fiduciary of Fast Trak. In the alternative, the Court could direct the trial court to consider whether to render void only the portion of the parties' agreement that calls for payment of interest in violation of the usury laws, or other theories that would entitle Fast Trak to some recovery of its investment.

Dated: New York, New York
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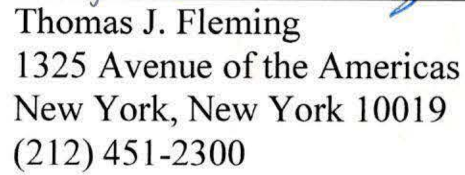
By: 

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CERTIFICATE OF COMPLIANCE

The foregoing brief was prepared on a computer using Microsoft Word, using Times New Roman 14 point typeface, except footnotes which are in Times New Roman 12 point typeface. The total number of words in this brief, excluding the Disclosure Statement, Questions Presented, Table of Contents, Table of Authorities, Proof of Service, and this statement is 13,211.

By: ______________________