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Georgia Supreme Court Ruling Is Helpful Precedent for Litigation Financing Industry

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Consistent with the weight of authority, the Georgia Supreme Court has ruled that certain litigation financing agreements structured as asset sales were not disguised "loans," and therefore not subject to the state's Industrial Loan Act (ILA) or Payday Lending Act (PLA). The decision is significant because it is helpful precedent not only for litigation financing providers facing similar challenges but also for providers of merchant cash advances and companies involved in other transactions structured as sales rather than loans.

In *Ruth v. Cherokee Funding, LLC*, both plaintiffs were injured in separate car accidents but retained the same attorney to file lawsuits on their behalf. The plaintiffs entered into financing agreements with Cherokee Funding in which the company agreed to provide them funds for personal expenses. The agreements provided that the plaintiffs had no obligation to repay the funds if they recovered nothing in their lawsuits, but, if they did recover damages, they would be required to repay the amounts provided by Cherokee Funding—together with a monthly use fee (which the Supreme Court characterized as interest) and certain other fees, up to the amount of their recoveries. The plaintiffs' dismissal of the lawsuits and retention of the funds received from Cherokee Funding would not cause them to be in default under the financing agreements.

After settling their lawsuits for unspecified amounts, the plaintiffs filed a putative class action against Cherokee Funding alleging that the financing agreements violated the ILA and PLA. The trial court granted in part and denied in part Cherokee Funding's motion to dismiss, concluding that the PLA applied but not the ILA. Having granted Cherokee Funding's application for interlocutory appeal, the Court of Appeals concluded that neither statute applied because the transaction was not a loan and instead was as an "investment contract." The plaintiffs then filed a petition for a writ of certiorari to the Georgia Supreme Court, which agreed "to consider whether the Court of Appeals correctly understood the scope of the [ILA] and the [PLA]."

The court looked at the ILA's definition of a "loan" as "any advance of money in an amount of $3,000 or less under a contract requiring repayment and any and all renewals of refinancing thereof or any part thereof." It also reviewed the PLA's language, which does not expressly define the term "loan" but provides that the PLA "shall apply with respect to all transactions in which funds are advanced to be repaid at a later date." The Georgia Supreme Court concluded that Cherokee Funding's financing agreement was neither "a contract requiring repayment" for purposes of the ILA nor a transaction "in which funds are advanced to be repaid" for purposes of the PLA because the agreement involved "a contingent and limited obligation of repayment."

The court also addressed the plaintiffs' argument that "the contingent repayment obligation in their financing agreements is illusory because Cherokee Funding only makes loans…when the risk that the contingency will fail to arise is close to null." It commented that "it is easy to imagine an agreement with a sham contingent repayment provision that reflects an attempt to evade the usury laws" and that, when faced with a claim that such a provision is a sham, a court "should look beyond the text of the agreement to [review the substance] and perhaps find an unlawful loan, notwithstanding the contingency." The court found, however, that—based on the pleadings before it—the case did not present such a claim, observing that the plaintiffs' complaint did not allege that the financing agreements' contingencies were illusory or that there was no chance the plaintiffs would be unsuccessful in their lawsuits.

Litigation financing providers continue to face the risk of future private lawsuits and regulatory attacks. In July 2018, the New York Department of Financial Services raised concerns about litigation financing and suggested that legislation containing consumer safeguards was needed. Such risks underscore the need for parties involved in litigation financing and other financing transactions structured as sales rather than loans to consult legal counsel to ensure that their transactions are properly structured to make them less vulnerable to usury and similar challenges.

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