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Trials &TRIBULATIONS

Limiting legal process by proxy

In a decision issued just last week, a divided New York State Court of Appeals applied the age-old doctrine of champerty, barring litigation brought by plaintiff Justinian Capital SPC ("Justinian"). *Justinian Capital SPC v. WestLB AG*, 2016 N.Y. Slip Op. 07047 (Oct. 27, 2016). This decision, however, has implications outside the commercial sector.

The court's decision went beyond applying a legal principle that can be traced to the feudal farmers of pre-revolutionary France. Of interest to all litigators, the interplay between the majority and dissenting opinions offers a unique perspective on this court's views of summary judgment when a court is faced with questions of intent.

Plowshares to pleadings – champerty defined

In feudal France, a tenant-by-champart "owned" the land, but was bound to share the profits of his harvest with the grantor. *See Bluebird Partners, L.P. v. First Fid. Bank, N.A.*, 94 N.Y.2d 726, 733–34 (2000). English Common Law used the term champerty "as a metaphor to indicate a disapproval of lawsuits brought for part of the profits of the action." Slip Op., p. 2. In New York, the doctrine of champerty is codified by New York Judiciary Law § 489.

Section 489 prohibits the purchase of debts or claims, including promissory notes, "with the intent and for the purpose of bringing an action or proceeding thereon...." Judiciary Law § 489(1). Section 489(2) contains a safe harbor provision designed to protect large-scale commercial transactions. The prohibitions in section 489(1) do not apply to any purchase or assignment having an aggregate purchase price of at least $500,000. *Id.* at § 489(2).

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Relying on this historical and legislative framework, the Court of Appeals addressed whether Justinian's rights as a plaintiff came from the champertous acquisition of notes and, if so, whether the purchase was protected by the safe harbor provision.

Non-party DPAG's share of the litigation harvest

Plaintiff Justinian brought this action against WestLB, seeking damages related to WestLB's management of the investment portfolios of two special purpose entities, Blue Heron VI Ltd. and Blue Heron VII Ltd. Justinian sought to recover losses related to notes issued by the Blue Heron entities, claiming fraud and malfeasance on the part of WestLB.

Importantly, Justinian was not the original purchaser of the notes. Indeed, days before claims against WestLB would have been barred by the statute of limitations, Justinian purchased the notes from nonparty Deutsche Pfandbriefbank AG ("DPAG").

DPAG invested roughly $209 million in notes issued by Blue Heron. By January 2008, the notes were virtually worthless. By the summer of 2009, DPAG's board of directors approved initiating litigation against WestLB. However, for political reasons, DPAG, a German bank receiving support from the German government, was leery of directly pursuing WestLB, another German financial institution. In February of 2010, DPAG discussed the sale of the notes with Justinian, "a Cayman Islands shell company with little or no assets." Slip Op., p. 4. In fact, Justinian's business plan centered on the purchase of failed investments. Justinian would then remit recoveries from any litigation back to the seller, minus Justinian's cut.

Toward that end, DPAG agreed to assign the notes to Justinian. Justinian would pay a base purchase price of $500,000 for the Blue Heron VI notes and $500,000 for the Blue Heron VII notes. Shortly after the agreement was executed, the notes were assigned to Justinian. Justinian then immediately commenced litigation against WestLB.

The assignment, however, was effected regardless of whether Justinian paid any amount to DPAG. Indeed, per the agreement, should Justinian fail to pay the purchase price, the apparent remedy was that Justinian's share of any proceeds recovered as part of the litigation would decrease from 20 percent to 15 percent. In fact, Justinian never paid any portion of the purchase price, nor did DPAG demand payment.

Not surprisingly, WestLB raised champerty as an affirmative defense. Following the completion of limited champerty-related discovery, WestLB filed a successful motion for summary judgment. The Appellate Division, First Department, unanimously affirmed the Supreme Court's decision.

Summary judgment blights the litigation sown by Justinian and DPAG

From a substantive perspective, the court's opinion is of interest to the commercial litigator. Authored by Chief Judge Janet DiFiore and joined by Judges

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Rivera, Abdus-Salaam, Fahey and Garcia, the majority opinion addressed the application of New York's champerty statute.

From a procedural perspective, of interest to all litigators is the interplay between the majority opinion and the dissent, authored by Judge Leslie E. Stein and joined by Judge Eugene F. Pigott. These opinions offer divergent views of the propriety of summary judgment when a court is faced with questions of intent.

Addressing the substance of champerty, as the court made clear, simply bringing an action following the purchase of a note or debt is not champertous. Instead, the crucial question is the purchaser's intent. A security purchased "for the very purpose of bringing…suit" constitutes champerty, as "this implies an exclusion of any other purpose." Slip Op., p. 7 (quoting *Moses v. McDivitt*, 88 N.Y. 62, 65 (1882)). Thus, "the foundational intent to sue on that claim must have at least have been the primary purpose for, if not the sole motivation behind, entering into the transaction." *Id*. at p. 8 (quoting *Bluebird Partners*, 94 N.Y.2d at 736).

The court found that DPAG sought to assign the notes to Justinian specifically to avoid serving as the plaintiff in any litigation. Moreover, Justinian's business plan centered on the acquisition of investments for the purpose of then bringing legal actions. The very essence of the assignment to Justinian was the institution of litigation. It "was not merely an incidental or secondary purpose." Thus, the acquisition of these notes was champertous. *Id.* at p. 9

The court then addressed whether the purchase of these notes was protected by the safe harbor provision in § 489(2). The court found that the protections of this provision could apply, regardless of whether the seller actually received payment. Nonetheless, Justinian was not entitled to the protections afforded by § 489(2).

Turning to the legislative history of the safe harbor provision, the court determined that the Legislature "did not intend either that actual payment necessarily had to have been made or that face value alone would suffice to obtain the protection of the safe harbor." *Id*. at p. 11. Indeed, since this provision was designed to encourage commercial transactions, requiring actual payment of at least $500,000 could "hinder the legislative goal of market fluidity." *Id*. at p. 12.

However, the court declined to apply the protections of the safe harbor provision when the purchase price is, in effect, contingent upon a successful recovery in the lawsuit. Again turning to the legislative history, the court found that a $500,000 purchase price was favored by the Legislature because buyers "would not invest large sums of money to pursue litigation unless the buyers believed in the value of their investments." *Id*. at p. 13. In contrast, a contingent arrangement would allow purchasers to take advantage of the protections of the safe harbor provision without incurring any concomitant risk.

Without the protections of the safe harbor provision, Justinian's purchase of the notes violated section 489, and the court affirmed summary judgment in favor of WestLB.

Reaping summary judgment amid questions of intent

The majority opinion addressed testimony by Justinian's principle, who claimed that alternatives other than litigation might have existed at the time of the acquisition. The notes themselves were due in 2047. Justinian claimed that some type of restructuring or distribution could have occurred, obviating the need to continue litigation. Or, perhaps WestLB could have filed for bankruptcy, thus allowing Justinian some type of recovery as a creditor. The court, however, rejected this testimony as speculation insufficient to defeat a motion for summary judgment, noting "we have long held that mere conclusions, expressions of hope or unsubstantiated allegations or assertions are insufficient." Slip Op., p. 9.

The dissenting opinion, however, took a different view. Namely, both the question of whether Justinian's conduct was champertous and the application of the safe harbor provision depends upon "the intent of one or both of the parties to that transaction, and such intent is – as in almost all cases – a factual issue" that cannot be decided on summary judgment. Slip Op., Dissent, p. 1. In fact, until this decision, the Court of Appeals had "never found summary judgment appropriate to hold a transaction champertous as a matter of law." *Id*. at p. 2.

The facts must be viewed in the light most favorable to the nonmoving party, and because champerty is an affirmative defense, WestLB bore the burden of demonstrating that the assignment was champertous. In sharp contrast to the majority opinion, the dissenting opinion credited the testimony of Justinian's principle, finding that this testimony was not "mere after-the-fact speculation," but instead, constituted sufficient evidence to create a question of fact. *Id*. at p. 4.

While the majority appeared to take issue with the negotiation of Justinian's acquisition on the eve of the expiration of the statute of limitations, the dissent viewed this fact as justifying Justinian's immediate commencement of litigation to protect its rights. Indeed, Justinian claimed that it attempted to contact defendants to discuss alternatives to litigation. Although defendants disputed receiving these communications, the dissent viewed this as another legitimate question of fact.

Moreover, the dissenting opinion noted that an agreement that includes the assignee's receipt of a percentage of any eventual collection does not make the transaction ***per se*** champertous. Instead, the acquisition agreement was at most ambiguous, requiring a court to ascertain the intent of the parties.

In short, whether questions of intent can be resolved at the summary judgment stage permeates the dissent's analysis. The differing approaches taken by the majority opinion and the dissent are of interest to all litigators.

Conclusion

The court's decision provides substantive guidance to those involved in structuring the acquisition of distressed instruments. For the rest of the bar, the court's dialogue provides important insight to the appropriateness of summary judgment in the face of possible questions of party intent.

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