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Expert Analysis

Recent Court of Appeals Case Sheds Light on Scope of Champerty Doctrine

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The New York Court of Appeals recently issued an important new opinion on the reach of New York Judiciary Law §489, which bars certain forms of trading in litigation claims. The decision, in the *Justinian Capital* case,[1] breathes new life into what is known as champerty, a doctrine many had thought to be largely dormant in New York following the issuance of the court's earlier decisions in *Bluebird Partners*[2] and *Love Funding*.[3] This article discusses the trio of Court of Appeals cases and the current state of the champerty law in New York.

Champerty, broadly speaking, is "a venerable doctrine developed hundreds of years ago to prevent or curtail the commercialization of or trading in litigation."[4] In New York, the doctrine (and an important safe harbor thereto) is codified in §489 of the Judiciary Law, which provides, in part, that no corporation "shall solicit, buy or take an assignment of … a bond, promissory note, bill of exchange, book debt, or other thing in action, or any claim or demand, with the intent and for the purpose of bringing an action or proceeding thereon."[5]

Thanks to two prominent decisions from the New York Court of Appeals in 2000 (*Bluebird Partners*) and 2009 (*Love Funding*), it was widely assumed for a time that champerty was a largely irrelevant consideration in the context of modern commercial trading in claims.[6] Indeed, language in *Love Funding* had led many to believe that the doctrine was essentially confined to claims purchases undertaken for the sole purpose of bringing frivolous or harassing suits so that the purchaser could profit from the legal fees or costs resulting from that litigation.[7]

> While the result in 'Justinian Capital' was met with surprise in some quarters, the case essentially affirms the long-standing view of the New York courts that whether a transaction violates §489 of the Judiciary Code will boil down to the question of whether the "primary purpose" of the transaction was to bring suit.

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It now appears that claims traders (and litigation funders) should not have been so sanguine. In *Justinian Capital*, the Court of Appeals expressly rejected a narrow reading of its earlier *Love Funding* decision[8] and made clear that the champerty doctrine retains vitality in New York. The *Justinian Capital* case involved a German bank that wished to sue another German bank for having mismanaged a portfolio of assets. However, the putative plaintiff was concerned with the political ramifications of its suit (because the defendant was part owned by the German government), so it sold the debt instruments that were affected by the alleged mismanagement to a litigation finance shop. The litigation finance firm (Justinian Capital) then brought suit only days after acquiring the notes, and the defendant sought dismissal on grounds of champerty. The Court of Appeals held that the transaction was champertous, concluding that "there was no evidence … that Justinian's acquisition of the notes was for any purpose other than the lawsuit it commenced almost immediately after acquiring the notes."[9]

While the result in *Justinian Capital* was met with surprise in some quarters, the case essentially affirms the long-standing view of the New York courts that whether a transaction violates §489 of the Judiciary Code will boil down to the question of whether the "primary purpose" of the transaction was to bring suit.[10] As such, the inquiry in any case is inherently factual, and not readily susceptible to bright-line rules. Nevertheless, from the trio of Court of Appeals cases, it is possible to identify certain key considerations that may bear on a finding of champerty under New York law.

Does the sale involve a debt instrument or a bare litigation claim? The sale of a litigation claim is a riskier proposition than the sale of a debt instrument the enforcement of which may involve litigation. None of the three prominent New York Court of Appeals cases involved the sale of a naked litigation claim. Thus, while those cases each provide a degree of comfort that the sale of a debt instrument will not be champertous so long as litigation is not the primary (or sole) reason for the transaction, they do not directly address the sale or assignment of a lawsuit.

Did the purchaser buy the litigation claim for purposes of pursuing a restructuring? Because a sale generally will not be champertous if it was motivated by a purpose other than pursuing litigation, it would appear that the purchase of a litigation claim for purposes of pursuing a restructuring might not violate the Judiciary Code. However, the question has not been definitively resolved, with the best evidence that such a motive would insulate the sale from attack coming from a dissenting opinion in *Justinian Capital*.[11]

Does the sale involve multiple assets, only one of which is a litigation claim? As the "primary purpose" test suggests, a sale is far less likely to be considered champertous if the purchaser bought a package of related assets, only one of which was a potential litigation claim. Thus, for instance, the Court of Appeals has rejected a champerty defense in circumstances where the plaintiff had purchased its predecessor-in-interest's operating assets along with a potential claims arising out of those assets.[12]

Does the sale qualify for the §489 "safe harbor"? Judiciary Code §489 contains a safe harbor, enacted in 2004, for sales of "bonds, promissory notes, bills of exchange and/or book debts … having an aggregate purchase price of at least five hundred thousand dollars."[13] This safe harbor does not apply if the sale

involves only a naked litigation claim unattached to any debt instrument. However, if a sale involves *both* (1) notes purchased for more than $500,000, *and* (2) a related litigation claim, then the safe harbor would extend to the litigation claim as well.[14] Importantly, *Justinian Capital* holds that the §489(2) safe harbor cannot be invoked if the "purchaser of notes or other securities structures an agreement to make payment of the purchase price contingent on a successful recovery in the lawsuit."[15]

Does the sale involve a litigation that has already been commenced? Litigations that are already in progress are arguably exempted from the champerty law. Section 489, by its plain terms, bars acquisitions of claims "for the purpose of *bringing* an action or proceeding thereon."[16] Thus, at least one court has held that "read strictly," the statute "extends only to the transfer of claims prior to the institution of any proceeding or action."[17]

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In sum, while there are a number of questions left unanswered by the *Justinian Capital* opinion, the case—together with the two recent cases that preceded it—provides important additional guidance (and a note of caution) to traders in litigation claims.

1. *Justinian Capital SPC v. WestLB AG*, 65 N.E.3d 1253 (N.Y. 2016).

2. *Bluebird Partners, L.P. v. First Fidelity Bank, N.A.*, 731 N.E.2d 581 (N.Y. 2000).

3. *Trust for the Certificate Holders of the Merrill Lynch Mortgage Investors Mortgage Pass-Through Certificates, Series 1999-C1 v. Love Funding*, 918 N.E.2d 889 (N.Y. 2009)

4. *Bluebird Partners*, 731 N.E.2d at 582.

5. Delaware courts apply a similar common-law doctrine (though the Delaware Supreme Court has not definitely ruled on the continuing validity of the doctrine in Delaware). See *Charge Injection Techs. v. E.I. Dupont De Nemours & Co.*, 2016 WL 937400 (Del. Super. Ct. March 9, 2016).

6. See generally *Bluebird Partners*, 731 N.E.2d at 582 ("Neither the history of the doctrine nor the case law of this Court support a matter of law application of the champerty doctrine to the acquisition of rights to claims that are integrated within the sophisticated market transactions like these."); *Love Funding*, 918 N.E.2d at 894 ("New York cases agree that if a party acquires a debt instrument for the purpose of enforcing it, that is not champerty simply because the party intends to do so by litigation.").

7. See *Love Funding*, 918 N.E.2d at 895 ("What the statute prohibits … is the purchase of claims with the intent and for the purpose of bringing an action that the purchaser may involve parties in costs and annoyance.") (citations, quotations, and alterations omitted).

8. See *Justinian Capital*, 65 N.E.3d at 1256, n.3 ("We reject Justinian's contention that Judiciary Law §489 has no application unless the underlying claim is frivolous or was brought by Justinian to secure 'costs.'").

9. *Justinian Capital*, 65 N.E.3d at 1257.

10. See *Justinian Capital*, 65 N.E.3d at 1256 ("The primary purpose test articulated in [*Moses v. McDivitt*, 88 N.Y. 62 (1882)] has been echoed in our courts for well over a century."). The Court of Appeals has not yet definitively resolved the question whether a litigation purpose need be the "sole" purpose, or merely the "primary" purpose, of the acquisition in order for the champerty doctrine to apply. See *Bluebird Partners*, 731 N.E.2d at 587 (noting the "distinction is one without a legal difference when the 'primary' element is present").

11. See *Justinian Capital*, 65 N.E.3d at 1260 (Stein, J., dissenting).

12. See *Fairchild Hiller v. McDonnell Douglas*, 28 N.Y.2d 325, 330 (N.Y. 1971).

13. As the Court of Appeals has recognized, "the safe harbor was enacted to exempt large-scale commercial transactions in New York's debt-trading markets from the champerty statute in order to facilitate the fluidity of transactions in these markets." *Justinian Capital*, 65 N.E.3d at 1258.

14. See N.Y. Judiciary Law §489(2) (providing that the safe harbor, once triggered, extends "to all other items, including other things in action, claims and demands" that are included in the transaction). It is not clear that the "artificial" packaging of unrelated assets would fall within the safe harbor. That being said, the Court of Appeals has observed, in dicta, that there is "no problem with parties structuring their agreements to meet the safe harbor's requirements." *Justinian Capital*, 65 N.E.3d at 1258.

15. *Justinian Capital*, 65 N.E.3d at 1258-59. The purpose of this restriction is to ensure that the buyer has "skin in the game" and will not pursue the sort of abusive litigation the champerty law seeks to discourage. Id.

16. N.Y. Judiciary Law §489(1) (emphasis added).

17. *Sygma Photo News v. Globe Int'l*, 616 F. Supp. 1153, 1157 (S.D.N.Y. 1985); but see *Ehrlich v. Rebco Ins. Exchange*, 225 A.D. 2d 75, 77 (N.Y. App. Div. 1996) (arguably rejecting the *Sygma* holding, though on grounds that may be distinguishable).