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Fraud Suit Violates NY's Champerty Doctrine, High Court Rules

BY JOEL STASHENKO

ALBANY - New York's highest court declined to reinstate breach-of-contract and fraud claims against an asset manager accused of making bad mortgage-based investments, finding that the suit represented a violation of the state's champerty doctrine.

Champerty prohibits the buying of assets for the express purpose of bringing suits and trading or commercializing in litigation.

The Court of Appeals' 5-2 ruling Thursday in *Justinian Capital SPC v. WestLB AG*, 155, said Justinian's "acquisition" of notes from the original holder of bad investments represented a "sham transaction" designed to put Justinian in a position to champertously sue WestLB.

The court, in fact, said Justinian never paid the $1 million called for in the purchase agreement it made with Deutsche Pfandbriefbank AG (DPAG) of Germany for the notes.

DPAG had initially invested about $209 million in 2003 in notes issued by WestLB through two affiliates. The notes, supported by mortgage-backed securities, were worth nothing or next to nothing by 2008, according to the ruling.

Justinian sued WestLB AB, New York Branch, in Manhattan Supreme Court within days of acquiring the notes in 2010.

Chief Judge Janet DiFiore, writing the majority, said the real purpose of Justinian's transaction was to bring a suit where evidence showed DPAG was reluctant to initiate under its own name for fear of antagonizing government officials in Germany, which has an investment in WestLB.

She referred to Justinian as a Cayman Island-based "shell company with little or no assets."

"There was no evidence, even following completion of the champtery-related discovery, that Justinian's acquisition of the notes was for any purpose other than the lawsuit it commenced almost immediately after acquiring the notes," DiFiore wrote. "The lawsuit was not merely an incidental or secondary purpose of the assignment, but its very essence."

The Court of Appeals in Albany

She added that, contrary to Justinian's assertion, the "safe harbor" provision of New York champerty law does not preserve its suit. The provision exempts from the statute the purchase of securities with an aggregate purchase price of at least $500,000.

DiFiore said Justinian has not actually paid any portion of the $1 million for the "transaction" with DPAG, and Justinian's "obligation to pay" does not satisfy the letter of the safe harbor provisions.

Judges Jenny Rivera, Sheila Abdus-Salaam, Eugene Fahey and Michael Garcia joined the majority decision.

Judge Leslie Stein, in dissent, said she disagreed with granting summary judgment in WestLB's favor. She said she favored allowing the case to go to trial for resolution of what she said were several outstanding questions of fact.

For instance, she said, Justinian had plausibly argued that the swift filing of the fraud suit right after it took ownership of the notes may have been due to the impending expiration of the statute of limitations and was not a cut-and-dried affirmation that Justinian's sole purpose of existing was the suit itself.

"The majority's decision discourages transactions aimed at fostering accountability in commercial dealings, generally, and, in this particular case, successfully forecloses litigation against parties that are alleged to have committed fraud against all of the investors in more than one portfolio," wrote Stein, who was joined by Judge Eugene Pigott Jr.

James Sabella, a director at Grant & Eisenhofer in Manhattan, represented Justinian.

Christopher Paparella, partner at Hughes Hubbard and Reed in Manhattan, appeared for WestLB.

The champerty statute is codified in Judiciary Law §489(1). DiFiore said the concept dates back to French feudal times, and Thursday's ruling cited its treatment by the Court of Appeals as early as *Sedgwick v. Stanton*, 14 NY 289 (1856).

The ruling affirmed findings by two lower courts that the Justinian fraud suit was champertous.

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