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Brian S. Fraser

PRACTICE AREAS

Business and
Commercial Disputes

Civil Litigation

Distressed Debt and
Claims Trading

Operational Advice

New York Court of Appeals hears oral argument regarding an *amicus curiae* brief filed by RK&O Partners Brian Fraser and Lucinda McConathy on behalf of the LSTA

Brian Fraser and Lucinda McConathy*Amicus Curiae Brief*

September 15, 2009

On September 9, 2009, the New York Court of Appeals heard an oral argument concerning the proper interpretation of New York's champerty statute in a case in which Richards Kibbe & Orbe Partners Brian Fraser and Lucinda McConathy filed an *amicus curiae* brief on behalf of The Loan Syndications & Trading Association, Inc. (the "LSTA"). The champerty statute prohibits an assignment of a claim "with the intent and for the purpose" of bringing suit. Over one hundred years of case law exists interpreting the statute (as amended from time to time), and yet it remains somewhat murky today what constitutes champerty under the statute.

BACKGROUND

The underlying dispute in the case involves an assignment of claims against Love Funding, an originator of commercial mortgage loans, to a Trust that serviced a pool of commercial mortgage loans that included certain Love Funding loans. Love Funding made representations and warranties relating to the quality of its loans to an intermediary financial institution that pooled and transferred the loans to the Trust. The intermediary in turn made representations and warranties to the Trust. One of the Love Funding loans was determined to have been obtained by fraud, triggering obligations under the representations and warranties. The Trust sued the intermediary. That litigation was settled in part by the Trust taking an assignment of the intermediary's claims against Love Funding. When the Trust brought suit on the assigned claims, Love Funding raised champerty as a defense.

The Trust argued that the assignment to protect its pre-existing interest in the Love Funding loans was not champerty. It asserted that it was not a "stranger" to the claim and was not fomenting unnecessary litigation.

Love Funding argued that the assignment was unlawful champerty and that, as a result, the Trust could not assert the assigned claims. Love Funding contended that whether a transaction is unlawful champerty depends in every case on a factual inquiry into whether at the time of the assignment the assignee had an intent to collect payment or an intent to sue. The Trust had already sued the borrower and obtained what it could in a foreclosure action, so Love Funding pointed to that as an indication that the Trust took the assignment with the intent to sue, not collect, on the debt.

NEW YORK COURT OF APPEALS HEARS ORAL ARGUMENT REGARDING AN *AMICUS CURIAE* BRIEF FILED BY RK&O PARTNERS BRIAN FRASER AND LUCINDA MCCONATHY ON BEHALF OF THE LSTA (Cont.)

The LSTA's brief explained that the ability to assert a claim to protect an investment in a corporate loan and recover on any losses is an essential component of the value of the financial instruments traded in the syndicated loan market, and that secondary market buyers – assignees of debt and related claims – rely on the validity and enforceability of the assigned claims in valuing the debt and managing their assets. The LSTA's brief cautioned against an overbroad interpretation of the champerty statute that would cast uncertainty over the value and transferability of loans and all their component rights, including claims.

A group of consumer advocate organizations filed an *amicus curiae* brief arguing that the champerty statute prohibits the acquisition of large portfolios of delinquent consumer debt at a discount in order to realize substantial profits through collection litigation and the threat of such litigation. The consumer advocates asserted that the Second Circuit's decision in *Elliot Associates, L.P. v. Banco de la Nacion*, 194 F.3d 373 (2d Cir. 1999) interpreting the champerty statute more narrowly was wrong.

ORAL ARGUMENT

The seven-judge panel peppered the lawyers for the Trust and Love Funding with probing questions regarding the logic and potential effect of their arguments. Much of the questioning concerned the potential effect of the Court's decision on the distressed debt market.

The Court posed a hypothetical in which a potential distressed debt buyer seeks advice from its New York lawyer about whether it can legally purchase distressed debt if it knows that it will likely need to sue to recover. The Court asked what advice the lawyer could give regarding whether the purchase of the distressed debt would be champerty. Love Funding's lawyer responded that the lawyer in the hypothetical would probably have to acknowledge that champerty could be a problem. One of the judges expressed concern that Love Funding's position could "shut down" the distressed debt business. Another judge pointed out the importance of preserving commercial activity in the State of New York and noted the need for certainty.

The Court did not seem to take comfort in various so-called "safe harbors" for certain transactions. The judges consistently asked the advocates to assume that the safe harbors did not apply in trying to frame a rule to distinguish lawful, enforceable assignments of claims and unlawful, champertous assignments.

On rebuttal, the Trust's lawyer focused on the potential effect of the Court's decision on the distressed debt market. He concluded by expressly referring the Court to the LSTA *amicus* brief, noting the distressed debt market's need for certainty as to the legitimacy of transactions in the market and the ability to enforce claims. The Trust warned that if champerty is a question of fact in every case that could wreak havoc in the financial markets.

Because the Court posed equally tough questions to the lawyers for both sides, it is difficult to predict what the Court's decision will be. Although the Court expressed concern for commercial certainty and preserving distressed debt and collection agency business, it also expressed concern that it not adopt an interpretation that "guts" the champerty statute.



NEW YORK COURT OF APPEALS HEARS ORAL ARGUMENT REGARDING AN *AMICUS CURIAE* BRIEF FILED BY RK&O PARTNERS BRIAN FRASER AND LUCINDA MCCONATHY ON BEHALF OF THE LSTA (Cont.)

TRUST FOR THE CERTIFICATE HOLDERS OF THE MERRILL LYNCH MORTGAGE INVESTORS, INC., MORTGAGE PASS-THROUGH CERTIFICATES, SERIES 1999-C1, by and through ORIX Capital Markets, LLC v. Love Funding Corp., Appeal No. 107 (oral argument held September 9, 2009).