

**RECENT SECOND CIRCUIT DECISION APPLIES
NEW YORK COURT OF APPEALS DECISION REGARDING
APPLICATION OF CHAMPERTY TO SECONDARY MARKET TRANSACTIONS**

In October, we published a client alert discussing the impact of a decision by the New York Court of Appeals (*Merrill Lynch Mortg. Investors, Inc. v. Love Funding Corp.* 2009 WL 3294928 (Oct. 15, 2009 Ct. App. N.Y.) (annexed)), which clarified the application of the law of champerty to secondary market claim assignments. The United States Court of Appeals for the Second Circuit had certified certain questions to the New York Court of Appeals, seeking clarification of New York State's champerty laws. We stated that the decision by the New York Court of Appeals – that it is not impermissible under New York state law for a party to acquire a debt instrument for the purpose of enforcing it, simply because the party intends to do so by litigation – should provide comfort to secondary market purchasers of distressed syndicated loans, trade claims and other forms of debt.

Armed with the responses to certified questions addressed to the New York Court of Appeals, the Second Circuit recently concluded that, as a matter of law, the transfer of claims – including the right to commence litigation to enforce the claims – did not constitute champerty in violation of New York law. In *Merrill Lynch Mortgage Investors, Inc. v. Love Funding Corp.*, No. 07-1050-cv, 2010 U.S.App. LEXIS 495 (2d Cir. Jan. 10, 2010) (also annexed), the Second Circuit reversed the trial court's finding of champerty for two reasons. First, the New York Court of Appeals' response to the certified questions effectively rejected the trial court's finding of champerty because the Plaintiff-Appellant had a preexisting proprietary interest in the underlying loans. Secondly, no remand was warranted because the trial evidence did not support a finding of any intent to generate new costs and, therefore, could not permit a finding of champerty on remand.



New York

Seven Times Square
New York, NY 10036
+1.212.209.4800
+1.212.209.4801 [fax]

Boston

One Financial Center
Boston, MA 02111
+1.617.856.8200
+1.617.856.8201 [fax]

Washington, DC

601 Thirteenth Street NW,
Suite 600
Washington, DC 20005
+1.202.347.2222
+1.202.347.4242 [fax]

Hartford

City Place I
185 Asylum Street
Hartford, CT 06103
+1.860.509.6500
+1.860.509.6501 [fax]

Providence

121 South Main Street
Providence, RI 02903
+1.401.276.2600
+1.401.276.2601 [fax]

London

8 Clifford Street
London, W1S 2LQ
United Kingdom
+44.20.7851.6000
+44.20.7851.6100 [fax]

Dublin

Alexandra House
The Sweepstakes
Ballsbridge, Dublin 4
Ireland
+353.1.664.1738
+353.1.664.1838 [fax]

www.brownrudnick.com

Information contained in this Alert is not intended to constitute legal advice by the author or the attorneys at Brown Rudnick LLP, and they expressly disclaim any such interpretation by any party. Specific legal advice depends on the facts of each situation and may vary from situation to situation.

Distribution of this Alert to interested parties does not establish an attorney-client relationship. The views expressed herein are solely the views of the authors and do not represent the views of Brown Rudnick LLP, those parties represented by the authors, or those parties represented by Brown Rudnick LLP.

This decision by Second Circuit should effectively remove any uncertainties secondary market participants may have regarding the application of champerty law in actions involving bank debt or trade claims transactions. As we recommended following the issuance of the New York Court of Appeals decision, secondary market purchasers accustomed to settlement using LSTA standard documentation should continue to rely on the validity and enforceability of the assigned claims in evaluating and managing their investments. Purchasers of trade claims and other types of financial instruments using non-LSTA documentation should make sure New York law governs all agreements and that each party thereto consents to jurisdiction in New York courts.

BROWN RUDNICK is an international law firm with offices in the United States and Europe. Our 200 attorneys provide assistance across key areas of the law, including corporate, intellectual property, tax, finance, bankruptcy and restructuring, government law and strategies, complex litigation and arbitration, government contracts, climate and energy, and real estate.

For further information on this topic, please contact your Brown Rudnick attorney or one of the following attorneys:

Steven F. Wasserman

+1.212.209.4999
swasserman@brownrudnick.com

Timothy C. Bennett

+1.212.209.4863
tbennett@brownrudnick.com

Robert J. Stark

+1.212.209.4862
rstark@brownrudnick.com

Andrew S. Dash

+1.212.209.4811
adash@brownrudnick.com

Lan L. Marinelli contributed to this Alert.



UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

August Term, 2008

(Argued: September 26, 2008)

Decided: January 11, 2010)

Docket No. 07-1050-cv

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, as Master Servicer and Special Servicer,

Plaintiff-Appellant,

—v.—

LOVE FUNDING CORPORATION,

Defendant-Appellee.

Before:

B.D. PARKER,¹ RAGGI, *Circuit Judges*, and KEENAN, *District Judge*.²

Appeal from a judgment in favor of Love Funding entered in the United States District
Court for the Southern District of New York (Shira A. Scheindlin, *Judge*), based on a

¹ Judge Barrington D. Parker was designated as the third member of the panel pursuant to then-Local Rule § 0.14(b), revised as Internal Operating Procedure E(b), replacing Judge Guido Calabresi, who recused himself earlier in these proceedings.

² District Judge John F. Keenan, of the United States District Court for the Southern District of New York, sitting by designation.

determination that the assignment of rights supporting plaintiff's suit was void as champertous. Having previously certified questions regarding the scope of New York's statutory proscription of champerty, see N.Y. Judiciary Law § 489(1), to the New York Court of Appeals, and having now received its response, this court concludes as a matter of law that the trial record cannot support a finding of champerty.

REVERSED AND REMANDED.

IRA M. FEINBERG, Hogan & Hartson LLP, New York, New York (Andowah Newton, Hogan & Hartson LLP, New York, New York, Lorane F. Hebert, Hogan & Hartson LLP, Washington, D.C., *on the brief*), *for Plaintiff-Appellant*.

ALEC W. FARR, Bryan Cave LLP, Washington, D.C. (Michael G. Biggers, Anna C. Ursano, Bryan Cave LLP, New York, New York, *on the brief*), *for Defendant-Appellee*.

REENA RAGGI, *Circuit Judge*:

Plaintiff, the Trust for the Certificate Holders of the Merrill Lynch Mortgage Investors, Inc., Mortgage Pass-Through Certificates, Series 1999-C1 (the "Trust") sued defendant Love Funding Corporation ("Love Funding"), the originator of a defaulted mortgage held by the Trust, for breach of various representations and warranties made in a mortgage loan purchase agreement. Love Funding asserted the defense of champerty based on the fact that the Trust was assigned the right to sue Love Funding as part of a settlement

of claims against UBS Real Estate Securities, Inc. (“UBS”), the successor in interest to Paine Webber Real Estate Securities, Inc. (“Paine Webber”),³ which funded the defaulted mortgage loan. After a bench trial in the United States District Court for the Southern District of New York, Judge Shira A. Scheindlin voided the assignment as champertous and entered judgment in favor of Love Funding. See Trust for Certificate Holders of Merrill Lynch Mortgage Investors, Inc., Mortgage Pass-Through Certificates, Series 1999-C1 v. Love Funding Corp. (“Trust v. Love Funding”⁴), 499 F. Supp. 2d 314 (S.D.N.Y. 2007).

On appeal, the Trust argued that the assignment could not be champertous because it had a preexisting interest in the loan giving rise to its claim. Because of ambiguities in the scope of New York’s statutory proscription of champerty, see N.Y. Judiciary Law § 489, we certified certain questions to the New York Court of Appeals, see Trust v. Love Funding, 556 F.3d 100, 114 (2d Cir. 2009). Having received the Court of Appeals’ response, see Trust v. Love Funding, 13 N.Y.3d 190, --- N.Y.S.2d --- (2009), we now conclude, as a matter of law, that the trial record does not permit a finding of champerty. Accordingly, we reverse the challenged judgment and remand the case to the district court for entry of judgment in favor of plaintiff and for a determination of damages.

³ Pursuant to a merger of their parent companies in 2000, UBS succeeded in interest to Paine Webber’s rights and obligations under the agreements relevant here.

⁴ Because, aside from the parties’ titles, this case bore the same full caption in the district court, this court, and the New York Court of Appeals, we henceforth use the shortened caption form in referencing the opinions of each of these courts.

I. Background

A. Securitization of the Arlington Loan

Although we assume familiarity with our prior opinion in this case, see Trust v. Love Funding, 556 F.3d 100, we briefly recite certain facts relevant to the decision reached today. In April 1999, Love Funding entered into a “conduit lending” arrangement with Paine Webber, which was memorialized in an April 23, 1999 mortgage loan purchase agreement (the “Love MLPA”). Under the Love MLPA, Love Funding represented to Paine Webber that no underlying mortgage loan was in default. In the event that Love Funding breached this, or any other, representation, the Love MLPA provided for certain remedies, including the “repurchase [of the] Mortgage Loan at the Repurchase Price,” Love MLPA § 5.03(b), and indemnification “from and against all demands, claims or asserted claims, liabilities or asserted liabilities, costs and expenses, including reasonable attorneys’ fees, incurred by an Indemnified Party, in any way arising from or related to any breach of any representation, warranty, covenant or agreement . . . hereunder,” id. § 9.14(a).

In July 1999, pursuant to the Love MLPA, Love Funding arranged a \$6.4 million mortgage loan (the “Arlington Loan”) to Cyrus II Partnership (“Cyrus”), which was secured by a mortgage on Louisiana property known as the Arlington Apartments. On November 1, 1999, Paine Webber sold and assigned 36 loans, including the Arlington Loan, to Merrill Lynch Mortgage Investors, Inc. (“Merrill Lynch”), pursuant to the Merrill Lynch mortgage loan purchase agreement (the “Merrill Lynch MLPA”). In the Merrill Lynch MLPA, Paine

Webber represented, as Love Funding had in the Love MLPA, that none of the mortgage loans was in default.

The loans were then securitized through a process that involved the creation of the plaintiff Trust. On November 1, 1999, Merrill Lynch assigned to the Trust all of its “right[s], title and interest . . . in, to and under (i) the Mortgage Loans [including the loans sold by Paine Webber], (ii) each Mortgage Loan Purchase Agreement and (iii) all other assets included or to be included” in the Trust. Pooling and Servicing Agreement § 2.01(a). Commercial mortgage-backed securities, entitling their holders to interest payments generated on the underlying mortgages including the Arlington Loan, were then issued and sold to investors.

B. Arlington Loan Default and Resulting Litigation

On March 8, 2002, the Trust declared the Arlington Loan to be in default and accelerated payment on the full amount of the loan. The Trust then commenced a mortgage foreclosure action in Louisiana state court, securing a ruling that Cyrus had committed fraud to obtain the Arlington Loan and that such fraud constituted an event of default. As a consequence, the Arlington Apartments were sold for approximately \$6.5 million in net proceeds, of which the Trust received \$5.9 million. The Trust also obtained a judgment of more than \$10 million against Cyrus and its principals.

In September and October 2002, the Trust brought several actions against UBS related to the sale of loans by Paine Webber to the Trust. With respect to the Arlington Loan, the

Trust's theory was that, because Cyrus's fraud put the Arlington Loan in default from the outset, Paine Webber (and, therefore, its successor UBS) necessarily breached its representation in the Merrill Lynch MLPA that "there is no material default." Merrill Lynch MLPA, Schedule I ¶ 7. On September 13, 2004, after two years of vigorous litigation, the Trust and UBS reached a settlement releasing the Trust's claims as to 33 loans. While UBS paid the Trust \$19.375 million in consideration for releases on 32 loans, the sole consideration for the Trust's release on the Arlington Loan was UBS's assignment of its rights under the Love MLPA.

C. District Court Proceedings

In November 2004, the Trust commenced this action against Love Funding for breach of the Love MLPA. On October 11, 2005, the district court granted summary judgment in favor of the Trust on its claim that Love Funding had breached its representation that the Arlington Loan was not in default; nevertheless, it allowed Love Funding to amend its answer to assert the affirmative defense of champerty.

On February 27, 2007, after a bench trial, the district court ruled that Love Funding had proved champerty because "the Trust's primary purpose in accepting the Assignment was to buy a lawsuit against Love Funding." Trust v. Love Funding, 499 F. Supp. 2d at 322. The district court relied on the fact that the Trust "carve[d] out . . . a single loan from a group of loans that were settled," id. at 324, and thereby "negotiated for itself 'a whole new lawsuit,' with the intent to 'basically . . . continu[e] a microcosm of the litigation that ha[d]

already been going on for the last three years with UBS,” id. at 322-23 (alterations in original). In reaching this conclusion, the district court further found that the Trust was motivated by a perception that it could recover more on the Arlington Loan by suing Love Funding than by pursuing a cash settlement because it would be able to recoup “millions of dollars in simple and default interest that have been accruing on the loan for years” and because it “could also potentially recover indemnification damages.” Id. at 323.

D. Certification of Questions to the New York Court of Appeals

On appeal, the Trust argued that New York’s champerty law did not apply to this lawsuit because the relevant statute “was never intended to prohibit assignments in complex commercial transactions where the assignee has a substantial interest at stake.” Appellant’s Br. at 26. Recognizing ambiguities in New York law, we certified the following questions to the New York Court of Appeals:

1. Is it sufficient as a matter of law to find that a party accepted a challenged assignment with the “primary” intent proscribed by New York Judiciary Law § 489(1), or must there be a finding of “sole” intent?
2. As a matter of law, does a party commit champerty when it “buys a lawsuit” that it could not otherwise have pursued if its purpose is thereby to collect damages for losses on a debt instrument in which it holds a pre-existing proprietary interest?
3. (a) As a matter of law, does a party commit champerty when, as the holder of a defaulted debt obligation, it acquires the right to pursue a lawsuit against a third party in order to collect more damages through that litigation than it had demanded in settlement from the assignor?

(b) Is the answer to question 3(a) affected by the fact that the challenged assignment enabled the assignee to exercise the assignor's indemnification rights for reasonable costs and attorneys' fees?

Trust v. Love Funding, 556 F.3d at 114.

E. New York Court of Appeals' Response

The New York Court of Appeals accepted our certification and answered the second question and both parts of the third question in the negative, rendering it unnecessary to answer our first inquiry. Trust v. Love Funding, 13 N.Y.3d at 198, --- N.Y.S.2d at ---.

In responding to our second question, the Court of Appeals emphasized that New York's prohibition of champerty "has always been 'limited in scope and largely directed toward preventing attorneys from filing suit merely as a vehicle for obtaining costs.'" Id. at 199 (quoting Bluebird Partners, L.P. v. First Fidelity Bank, N.A., 94 N.Y.2d 726, 734, 709 N.Y.S.2d 865, 870 (2000)). The Court of Appeals distinguished between "acquiring a thing in action in order to obtain costs," which constitutes champerty, "and acquiring it in order to protect an independent right of the assignee," which does not. Trust v. Love Funding, 13 N.Y.3d at 199, --- N.Y.S.2d at ---. "[I]f 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." Id. at 200, --- N.Y.S.2d at ---. Noting our observation that the Trust had a preexisting proprietary interest in the Arlington Loan, the Court of Appeals concluded that, "[i]f, as a matter of fact, the Trust's purpose in taking assignment of UBS's rights under the Love MLPA was to enforce its rights, then, as a matter of law, given that the Trust had a

preexisting proprietary interest in the loan, it did not violate Judiciary Law § 489(1).” Id. at 202, --- N.Y.S.2d at ---.

Our third question asked whether the Trust’s intent either to recover more in damages from a lawsuit than from a potential settlement or to be indemnified for reasonable costs and attorneys’ fees evidenced champerty. The New York Court of Appeals concluded that it did not.

To acquire indemnification rights to the costs of past litigation is not to acquire a thing in action in order to obtain costs from prosecution thereon. Similarly, no New York case has been brought to our attention that stands for the proposition that it is champerty to settle a dispute by accepting a transfer of rights that has the potential for a larger recovery than one had demanded as a cash settlement.

Id. at 202-03, --- N.Y.S.2d at --- (footnote omitted).

II. Discussion

Upon receipt of the New York Court of Appeals’ response, the parties filed supplemental papers with this court in which they effectively agree that the district court – operating without the benefit of the Court of Appeals’ recent explication of New York champerty law – applied a more expansive definition of champerty than was warranted. Love Funding urges us to remand the case to allow the district court to determine whether it nevertheless still finds champerty proved under the standard set forth in the Court of Appeals’ response decision. The Trust on the other hand argues for reversal, submitting that, as a matter of law, the record will not permit a finding of champerty. We agree with the

latter argument and accordingly reverse the challenged judgment in favor of Love Funding.

A. The New York Court of Appeals’ Decision Effectively Rejects the District Court’s Finding of Champerty

New York’s statutory prohibition against champerty states, in pertinent part:

[N]o corporation or association, directly or indirectly, itself or by or through its officers, agents or employees, shall solicit, buy or take an assignment of, or be in any manner interested in buying or taking 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

N.Y. Judiciary Law § 489(1). The district court found that the challenged assignment violated this statute because “the Trust’s primary purpose in accepting the Assignment was to buy a lawsuit against Love Funding.” Trust v. Love Funding, 499 F. Supp. 2d at 322.

In answering our second certified question, however, the New York Court of Appeals clarified that such an intent to sue is insufficient, by itself, to violate the statute. As the Court of Appeals explained, New York’s champerty statute “does not apply when the purpose of an assignment is the collection of a legitimate claim.” Trust v. Love Funding, 13 N.Y.3d at 201, --- N.Y.S.2d at ---. Thus, “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.” Id. at 200, --- N.Y.S.2d at ---. Applying these principles to this case, the Court of Appeals concluded that “if, as a matter of fact, the Trust’s purpose in taking assignment of UBS’s rights under the Love MLPA was to enforce its rights, then, as a matter of law, given that the Trust had a preexisting proprietary interest in the loan, it did not violate Judiciary Law

§ 489(1).” Id. at 202, --- N.Y.S.2d at ---. This effectively rejects the district court’s finding of champerty.

B. Because the Trial Evidence Will Not Permit a Finding of Champerty, No Remand Is Warranted in this Case

Love Funding submits that the conditional language at the start of the last quoted passage from the Court of Appeals’ decision signals a need to remand this case to permit the district court to resolve a previously unconsidered fact question: whether the Trust’s intent in taking the UBS assignment of rights was, in fact, to enforce its interest in the Arlington Loan. Such a remand is warranted, however, only if the trial record presents sufficient evidence on the point to allow a factfinder to resolve it in favor of Love Funding, i.e., to find that the Trust intended to sue not to enforce rights under the Love MLPA, but rather to generate and recover the costs of such litigation. See Sporty’s Farm LLC v. Sportsman’s Mkt., Inc., 202 F.3d 489, 497 (2d Cir. 2000) (declining to remand when “the findings of the district court, together with the rest of the record, enable us to apply the new law to the case before us without difficulty”). That is not this case.

At the outset, we note that undisputed evidence establishes that, even before the challenged UBS assignment, the Trust had a significant interest in the repayment of the Arlington Loan. As this court observed in our prior decision, “[t]he Trust was not . . . a party with no interest in the loans that Love Funding had transferred to PaineWebber pursuant to the Love MLPA. To the contrary, as the end holder of the Arlington Loan, the Trust was the

party that would directly suffer the damages of any default on that instrument.” Trust v. Love Funding, 556 F.3d at 111. The district court recognized that, by accepting the challenged UBS assignment of rights under the Love MLPA, the Trust acquired the right directly to enforce the Arlington Loan. Nevertheless, the district court denominated the assignment champertous because it determined that the Trust intended from the start to pursue its rights through litigation in order to achieve the greatest possible recovery. See Trust v. Love Funding, 499 F. Supp. 2d at 322-23. As already noted, the Court of Appeals has now clarified that an assignment “is not champert[ous] simply because the party intends to [enforce its rights] by litigation.” Trust v. Love Funding, 13 N.Y.3d at 200, --- N.Y.S.2d at ---.

Love Funding thus shifts its argument to contend that, on remand, the district court might conclude that the Trust’s purpose in accepting the UBS assignment was “not to enforce its interests in the Arlington Loan, but to engage in a speculative litigation venture against Love Funding to generate and recover costs and damages far greater than its actual Arlington losses.” Appellee’s Supp. Br. at 7. To be sure, litigation for the purpose of generating and then recovering costs is the essence of champerty under New York law. See Trust v. Love Funding, 13 N.Y.3d at 199, --- N.Y.S.2d at ---. But the record evidence will not support such a characterization where, as here, the challenged assignment allowed the Trust directly to enforce its pre-existing interest in the Arlington Loan.

Love Funding asserts that an inference of champerty can be drawn from the fact that

the Trust originally estimated its losses from the Arlington Loan at \$3 million. After assignment of UBS's interests, however, the Trust demanded that Love Funding cure its breaches or repurchase the loan for \$10 million. The discrepancy is understandable. With UBS's rights under the Love MLPA, the Trust acquired claims to indemnification as well as to actual loan losses. Even if the \$10 million demand was excessive under the Love MLPA, however, that fact cannot by itself demonstrate that the Trust's intent was to employ litigation to profit from the costs and fees generated therein rather than to recoup "the full value of its . . . contractual claims." Promenade v. Schindler Elevator Corp., 39 A.D.3d 221, 223, 834 N.Y.S.2d 97, 99 (1st Dep't 2007). As the New York Court of Appeals explained in response to our certified questions, it is not champerty "to settle a dispute by accepting a transfer of rights that has the potential for a larger recovery than one had demanded as a cash settlement." Trust v. Love Funding, 13 N.Y.3d at 202-03, --- N.Y.S.2d at ---.

To the extent Love Funding insists that the Trust's champertous purpose is evidenced by its efforts to use this action to recover litigation costs and fees previously incurred by itself and UBS in connection with the disputed loans, Love Funding conflates litigation instituted for the purpose of generating costs therein, which constitutes champerty, and litigation to enforce contract rights to previously incurred costs, which is effectively an action on a debt instrument. See id. at 200, --- N.Y.S.2d at --- (observing that acquisition of "a debt instrument for the purpose of enforcing it . . . is not champerty simply because the party intends to do so by litigation"). The Court of Appeals recognized as much in specifically

rejecting Love Funding’s argument that the Trust’s intent to sue Love Funding “not only to be made whole on losses sustained from the Arlington Loan default, but also to profit from the past litigation” evidenced champerty. Id. at 202, --- N.Y.S.2d at ---. It explained that it is not champerty “to acquire . . . indemnification rights for reasonable costs and fees that were incurred in past legal actions.” Id. (observing further that “[t]o acquire indemnification rights to the cost of past litigation is not to acquire a thing in action in order to obtain costs from prosecution thereon” (emphasis added)). In short, even if the Trust’s entitlement to previously incurred costs and fees under the Love MLPA is sufficiently debatable to view that part of its pending claim as a “speculative litigation venture,” Appellee’s Supp. Br. at 8, the Trust’s acquisition and pursuit of that claim cannot evidence champerty.⁵

In expressing concern about the Trust’s litigation to recover “millions of dollars more than the Trust had been prepared to accept from UBS on the Arlington Loan,” the district court referenced only the “interest that [has] been accruing on the loan for years” and “indemnification damages from Love Funding under . . . the Love MLPA,” Trust v. Love Funding, 499 F. Supp. 2d at 323, neither of which can support a champerty finding in light of the Court of Appeals’ responsive decision, see Trust v. Love Funding, 13 N.Y.3d at 202-

⁵ While we express no view on the district court’s calculation of damages on remand, we note that to the extent it indicated a preliminary inclination to award \$1,736,668.35 in damages, an amount that excluded indemnification for costs the Trust incurred pursuing Cyrus, see Trust v. Love Funding, 499 F. Supp. 2d at 325 n.79, the Trust’s recovery here could actually be less than its initial estimated loss of \$3 million on the Arlington Loan. Accordingly, this lawsuit is unlikely to yield the hypothetical “profit” that Love Funding challenges.

03; --- N.Y.S.2d at ---. The district court made no finding that the Trust intended to generate new costs in this litigation. Because such cost-generation was the essence of champerty even at the time of the district court's decision, see Bluebird Partners, L.P. v. First Fidelity Bank, N.A., 94 N.Y.2d at 734, 709 N.Y.S.2d at 870, we can hardly conclude that the district court inadvertently neglected to make such a critical finding while instead reaching for a broader construction of champerty. Because the record does not support a finding of intent to generate new costs, we conclude that remand for further factfinding is unnecessary in this case. Love Funding's champerty defense fails as a matter of law.

III. Conclusion

To summarize, in light of the New York Court of Appeals' response to our certified questions in this case, see Trust v. Love Funding, 13 N.Y.3d 190, --- N.Y.S.2d ---, we conclude as a matter of law that the trial record does not permit the Trust's acquisition of UBS's rights under the Love MLPA to be held champertous in violation of New York Judiciary Law § 489(1). Accordingly, we REVERSE the judgment of the district court in favor of Love Funding, and we REMAND the case for entry of judgment in favor of the Trust and a calculation of damages.

Court of Appeals of New York.

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 as Master Servicer and Special Servicer, Appellant,

v.

LOVE FUNDING CORPORATION, Respondent.
Oct. 15, 2009.

[Ira M. Feinberg](#), for appellant.

[Alec W. Farr](#), for respondent.

Loan Syndications & Trading Association Inc.; Northern Manhattan Improvement Corporation et al., amici curiae.

[PIGOTT, J.](#)

[1] The United States Court of Appeals for the Second Circuit has certified to us questions relating to [Judiciary Law § 489](#), New York's champerty statute. We hold that a corporation or association that takes an assignment of a claim does not violate [Judiciary Law § 489](#)(1) if its purpose is to collect damages, by means of a lawsuit, for losses on a debt instrument in which it holds a pre-existing proprietary interest.

I.

Love Funding Corporation (“Love Funding”), a commercial mortgage-banking corporation, entered into a Mortgage Loan Purchase Agreement (“the Love MLPA”) with Paine Webber Real Estate Securities Inc. (“Paine Webber”) on April 23, 1999. Under the Love MLPA, Love Funding originated mortgage loans, evaluating the borrowers and performing due diligence, while Paine Webber provided financing and was ultimately assigned the loans for securitization. Love Funding received a fee of 1% of the principal amount of each loan.

In the Love MLPA, Love Funding represented that the loans were not in default. Love Funding further promised that in the event it breached any representa-

tion or warranty, and upon prompt written notice, it would cure the breach or, at Paine Webber's option, repurchase the affected mortgage loan. Significantly, in section 9.14(a) of the Love MLPA, Love Funding agreed to indemnify Paine Webber “from and against all demands, claims or asserted claims, liabilities or asserted liabilities, costs and expenses, including reasonable attorneys' fees, incurred ... in any way arising from or related to any breach.”

In July 1999, Love Funding made a \$6.4 million loan to Cyrus II Partnership, secured by a mortgage on an apartment complex, the Arlington Apartments, in Harvey, Louisiana. The loan was assigned to Paine Webber under the Love MLPA. As consideration, Love Funding received its 1% fee.

Paine Webber sold the Arlington Loan to Merrill Lynch Mortgage Investors, Inc. on November 1, 1999, as part of a larger securities transaction involving numerous mortgage loans. Under the governing Mortgage Loan Purchase Agreement (“the Merrill Lynch MLPA”), Paine Webber made representations and warranties concerning the loans, including ones substantively similar to those made by Love Funding in the Love MLPA.

The loans were then securitized, under a pooling and servicing agreement in which certificates secured by the underlying mortgages were issued, and a trust created for the holders of those certificates, who would receive interest payments generated by the loans. The trust was denominated the Trust for the Certificate Holders of the Merrill Lynch Mortgage Investors, Inc. Mortgage Pass-Through Certificates, Series 1999-C1 (“the Trust”). Orix Real Estate Capital Markets, LLC (“Orix”) was named Master Servicer and Special Servicer.

The Trust declared the Arlington Loan to be in default in March 2002, for reasons not directly pertinent to this case, and it commenced a mortgage foreclosure action in Louisiana state court.^{[FN1](#)} It was discovered that Cyrus's principals had committed fraud in obtaining the Arlington Loan. The Trust informed Paine Webber's successor in interest, UBS.^{[FN2](#)} In the fall of 2002, the Trust commenced litigation against UBS in federal court and in state courts in Texas and

New York, related to over thirty loans that Paine Webber had sold. With respect to the Arlington Loan, the Trust's theory was that Cyrus's fraud had put the loan in default from the outset, so that Paine Webber (and, hence, UBS) had necessarily breached its representation in the Merrill Lynch MLPA. By all accounts, the litigation was intense and expensive, with the Trust and UBS purportedly spending some \$7 million and over \$30 million respectively.

On September 13, 2004, the Trust and UBS settled, with UBS agreeing to pay the Trust \$19.375 million with regard to various loans deposited in the Trust. With respect to the Arlington Loan, however, UBS assigned to the Trust, as consideration for its release, all its rights under the Love MLPA: "each and every of the representations and warranties, and related remedies for breach thereof ... including but not limited to the remedies set out in section 9.14" of the Love MLPA.^{FN3}

In November 2004, a representative of the Trust approached Love Funding's principals, by telephone and in writing, demanding that Love Funding either cure its breaches of representations and warranties affecting the Arlington Loan or repurchase the loan. According to Love Funding, the Trust representative demanded \$10 million to settle. At the same time, the Trust commenced an action against Love Funding in Supreme Court, New York County, alleging that it had breached its representations and warranties that the Arlington Loan was not in default at the time of closing.

The Trust's action was removed to federal court. Both the Trust and Love Funding moved for summary judgment. On October 11, 2005, the United States District Court for the Southern District of New York granted the Trust's motion for summary judgment to the extent of holding that Love Funding breached the Love MLPA. Although denying Love Funding's cross-motion for summary judgment, the District Court allowed Love Funding to amend its Answer to assert a champerty defense.

In a February 27, 2007 decision, the District Court held that the Trust had "accepted the assignment of the Love MLPA with the primary purpose of bringing a lawsuit against Love Funding. Because the assignment is void for champerty, the Trust is not entitled to any award of damages." The District Court

noted that the assignment was the only consideration the Trust took in exchange for releasing UBS with respect to the Arlington Loan, and observed that the Trust had urged the court to find that Love Funding must indemnify the Trust for some of the legal fees UBS incurred defending itself against the Trust. Dismissing the Trust's efforts at settlement as a sham, the District Court concluded that the Trust's primary purpose was to secure a means of suing Love Funding, and dismissed its action.

On appeal, the Trust argued principally that a finding that it had accepted the assignment with the intention of suing Love Funding is insufficient as a matter of law for champerty. The United States Court of Appeals for the Second Circuit decided that resolution of the Trust's appeal depended on significant and unsettled questions of New York law. The Second Circuit certified to us, and we accepted, the following questions:

1. Is it sufficient as a matter of law to find that a party accepted a challenged assignment with the "primary" intent proscribed by [New York Judiciary Law § 489\(1\)](#), or must there be a finding of "sole" intent?
2. As a matter of law, does a party commit champerty when it "buys a lawsuit" that it could not otherwise have pursued if its purpose is thereby to collect damages for losses on a debt instrument in which it holds a pre-existing proprietary interest?
3. (a) As a matter of law, does a party commit champerty when, as the holder of a defaulted debt obligation, it acquires the right to pursue a lawsuit against a third party in order to collect more damages through that litigation than it had demanded in settlement from the assignor?

(b) Is the answer to question 3(a) affected by the fact that the challenged assignment enabled the assignee to exercise the assignor's indemnification rights for reasonable costs and attorneys' fees?

([556 F.3d 100, 114](#) [2d Cir2009].)

We answer the second certified question, and both parts of the third certified question, in the negative. Because—as the Second Circuit itself hinted—"the criti-

cal issue to assessing the sufficiency of the champerty finding is not the denomination of the Trust's intent as 'primary' or 'sole,' but the purpose behind its acquisition of rights that allowed it to sue [Love Funding](#)" (556 F.3d at 111), we find it unnecessary to answer the first certified question.

II.

[2][3] The doctrine of champerty developed "to prevent or curtail the commercialization of or trading in litigation" ([Bluebird Partners, L.P. v. First Fid. Bank, N.A.](#), 94 N.Y.2d 726, 729 [2000]). The doctrine, which has ancient and medieval roots (see [Bluebird Partners](#), 94 N.Y.2d at 733-734, 709 N.Y.S.2d 865, 731 N.E.2d 581; Martin, [Syndicated Lawsuits: Illegal Champerty or New Business Opportunity?](#), 30 Am Bus L J 485 [1992]; Radin, [Maintenance by Champerty](#), 24 Cal L Rev 48 [1936]), is currently codified in [Judiciary Law §§ 488-489](#), which derive from sections 274 and 275 of the former Penal Law. The latter section applied to all corporations and associations a proscription that had long governed legal practitioners (see Act of June 9, 1939, ch 822, § 13, 1939 N.Y. Laws 2055, at 2058). Under [Judiciary Law § 489](#)(1), a corporation or association may not "solicit, buy or take an assignment of, or be in any manner interested in buying or taking 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." ^{FN4} The champerty statutes are directed at preventing the "strife, discord and harassment" that would be likely to ensue "from permitting attorneys and corporations to purchase claims for the purpose of bringing actions thereon" ([Fairchild Hiller Corp. v. McDonnell Douglas Corp.](#), 28 N.Y.2d 325, 329 [1971]).

The term "champerty" referred in the Middle Ages to any "situation where someone bought an interest in a claim under litigation, agreeing to bear the expenses but also to share the benefits if the suit succeeded" ([Bluebird Partners](#), 94 N.Y.2d at 734, 709 N.Y.S.2d 865, 731 N.E.2d 581). In New York, however, the prohibition of champerty has always been "limited in scope and largely directed toward preventing attorneys from filing suit merely as a vehicle for obtaining costs" (*id.*). ^{FN5} Our earliest cases and those of the Court of Chancery clearly demonstrate this narrow scope.

In [Baldwin v. Latson](#) (2 Barb Ch 306 [1847]), the Court of Chancery explained that the purpose of New York's champerty statute "was to prevent attorneys and solicitors from purchasing debts, or other things in action, for the purpose of obtaining costs from a prosecution thereof, and [it] was never intended to prevent the purchase for the honest purpose of protecting some other important right of the assignee" (2 Barb Ch at 308). In [Moses v. McDivitt](#) (88 N.Y. 62 [1882]), we endorsed the Chancery Court's analysis, repeating its distinction between acquiring a thing in action in order to obtain costs and acquiring it in order to protect an independent right of the assignee (see 88 N.Y. at 65). In *Moses*, plaintiff, an attorney, bought a bond and mortgage from defendant in order to coerce the defendant, as a condition of extending his time of payment, to assign to plaintiff certain stock in a company. "This purpose, whether honest or reprehensible, was not within the prohibition of the statute.... The real question upon which the case turned was, whether the main and primary purpose of the purchase was to bring a suit and make costs, or whether the intention to sue was only secondary and contingent, and the suit was to be resorted to only for the protection of the rights of the plaintiff, in case the primary purpose of the purchase should be frustrated." (88 N.Y. at 68.)

We have also held that the champerty statute is violated by an attorney "only if the primary purpose of the purchase or taking by assignment of the thing in action is to enable the attorney to commence a suit thereon" ([Sprung v. Jaffe](#), 3 N.Y.2d 539, 544 [1957]). In describing champerty in terms of an acquisition made with the purpose of bringing a lawsuit (see also [Bluebird Partners](#), 94 N.Y.2d at 736, 709 N.Y.S.2d 865, 731 N.E.2d 581), we intended to convey the difference between one who acquires a right in order to make money from litigating it and one who acquires a right in order to enforce it.

[4] 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. The inquiry into purpose is a factual one. ^{FN6} In [Promenade v. Schindler El. Corp.](#) (39 AD3d 221 [1st Dept 2007]), for example, The Glick Organization, a general contractor, sued by The Promenade for reasons not relevant here, commenced a third-party action for contractual indemnification

against some of its subcontractors, including De-Con Mechanical Corp. Promenade and Glick settled. The settlement agreement provided not only that Glick pay Promenade \$1.8 million but also that Glick assign Promenade its claim for contractual indemnification against De-Con. The Appellate Division rejected De-Con's argument that the assignment was void for champerty. De-Con's contention was belied by the fact that Promenade had accepted the assigned claim for the purpose of pursuing the full value of its settlement of contractual claims, not for the purpose of "bringing a claim against De-Con either as an investment or to harass or injure it" ([39 AD3d at 223](#)).

Similarly, in [Williams Paving Co. v. United States Fidelity & Guaranty Co.](#) (67 A.D.2d 827 [4th Dept 1979]), plaintiff, a corporation that owned a machine damaged by the Joneses, obtained judgment of \$27,008.50. Defendant insured the Joneses to a maximum of \$5,000. It was alleged that plaintiff had offered to settle the claim within the policy limits and defendant, acting in bad faith, had refused to do so. Plaintiff's insurer became subrogated to plaintiff's claim against the Joneses, and plaintiff sued as nominee of its insurer and assignee of the Joneses, asserting defendant's bad faith. The Appellate Division held that plaintiff's "primary purpose was to protect its own interest in attempting to collect its judgment against the Joneses" and that, in taking the assignment from the Joneses, plaintiff, rather than acting with litigious purpose, had a relationship with the Joneses that gave it a substantial, legitimate interest in the transactions involved in the suit ([67 A.D.2d at 828](#)).

[5] Many other New York cases can be cited for the same principle (*see e.g.* [Red Tulip, LLC v. Neiva](#), 44 A.D.3d 204, 213-214, 842 N.Y.S.2d 1 [1st Dept 2007]); [Hill Int'l, Inc. v. Town of Orangetown](#), 290 A.D.2d 416, 417, 736 N.Y.S.2d 77 [2d Dept 2002]; [G.G.F. Dev. Corp. v. Andreadis](#), 251 A.D.2d 624, 676 N.Y.S.2d 488 [2d Dept 1998]; [Small Business Admin. v. Mills](#), 203 A.D.2d 654, 655, 610 N.Y.S.2d 371 [3d Dept 1994]; [Am. Bag & Metal Co. v. Alcan Aluminum Corp.](#), 115 A.D.2d 958, 959-960, 497 N.Y.S.2d 787 [4th Dept 1985]; [Limpas Realty Corp. v. Uswiss Realty Holding, Inc.](#), 112 A.D.2d 834, 836-837, 492 N.Y.S.2d 754 [1st Dept 1985]; [1015 Gerald Realty Corp. v. A & S Improvements Corp.](#), 91 A.D.2d 927, 928, 457 N.Y.S.2d 821 [1st Dept 1983]; [Prudential Oil Corp. v. Phillips Petroleum Co.](#), 69

[A.D.2d 763](#), 415 N.Y.S.2d 217 [1st Dept 1979]; [American Express Co. v. Control Data Corp.](#), 50 A.D.2d 749, 750, 376 N.Y.S.2d 153 [1st Dept 1975]; [Concord Landscapers, Inc. v. Pincus](#), 41 A.D.2d 759, 341 N.Y.S.2d 538 [2d Dept 1973]). In short, the champerty statute does not apply when the purpose of an assignment is the collection of a legitimate claim. What the statute prohibits, as the Appellate Division stated over a century ago, "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, where such claims would not be prosecuted if not stirred up ... in [an] effort to secure costs" ([Wightman v. Catlin](#), 113 A.D. 24, 27, 28, 98 N.Y.S. 1071 [2d Dept 1906]).

[6] In the present case, as the Second Circuit explains, the Trust, as the holder of the Arlington Loan and the party that would directly suffer the damages of any default on that loan, had a pre-existing proprietary interest in the loan ([556 F.3d at 111](#)). If, as a matter of fact, the Trust's purpose in taking assignment of UBS's rights under the Love MLPA was to enforce its rights, then, as a matter of law, given that the Trust had a pre-existing proprietary interest in the loan, it did not violate [Judiciary Law § 489](#)(1). Accordingly, we answer the second certified question in the negative.

III.

[7] The Second Circuit also asks us to clarify the application of the champerty doctrine to certain facts of the present case. The District Court found that the Trust's intent in suing Love Funding was to recover more in compensation for its losses on the Arlington Loan than it had demanded in settlement from UBS on the Arlington Loan. Moreover, the District Court noted that, in accepting the assignment, the Trust believed that Love Funding could be made to indemnify the Trust for a portion of the legal fees UBS incurred defending itself against the Trust.^{EN7} The District Court concluded that the Trust's intent in suing Love Funding was not only to be made whole on losses sustained from the Arlington Loan default, but also to profit from the past litigation, a purpose the District Court found consistent with champerty.

[8][9] Love Funding does not identify, and we are not aware of, any New York case holding that it is champerty to acquire, as part of a settlement, indemnifica-

tion rights for reasonable costs and fees that were incurred in past legal actions. To acquire indemnification rights to the costs of past litigation is not to acquire a thing in action in order to obtain costs from prosecution thereon.^{FN8} Similarly, no New York case has been brought to our attention that stands for the proposition that it is champerty to settle a dispute by accepting a transfer of rights that has the potential for a larger recovery than one had demanded as a cash settlement. Nor would it be possible in many cases to assess whether rights are likely to yield a larger recovery than earlier demanded. Consequently we answer both parts of the third certified question in the negative.

Accordingly, the first certified question should not be answered as unnecessary, the second certified question should be answered in the negative, the first part of the third certified question should be answered in the negative, and the second part of the third certified question should be answered in the negative.

Following certification of questions by the United States Court of Appeals for the Second Circuit and acceptance of the questions by this Court pursuant to section 500.27 of the Rules of Practice of the New York State Court of Appeals, and after hearing argument by counsel for the parties and consideration of the briefs and the record submitted, certified questions answered in accordance with the opinion herein.

Chief Judge [LIPPMAN](#) and Judges [CIPARICK](#), [GRAFFEO](#), [READ](#), SMITH and [JONES](#) concur.

[FN1](#). In October 2004, the Arlington Apartments complex was sold for some \$6.5 million, from which the Trust received about \$5.9 million. That December, the Trust was awarded approximately \$10.9 million in damages against Cyrus and its principals, though it is not clear how much of that amount is collectible.

[FN2](#). In November 2000, following a merger of their parent companies, UBS succeeded in interest to Paine Webber's rights and obligations under the Love MLPA.

[FN3](#). The agreement memorializing the "Assignment of claims and causes of action" was signed by the parties on November 18,

2004, but by its terms had become effective on September 13, 2004.

[FN4](#). [Judiciary Law § 488](#)(1) applies a similar proscription to attorneys and counselors.

[FN5](#). Payment of attorneys by fees that are contingent upon successful litigation and derived from its proceeds is expressly permitted in the champerty statute ([Judiciary Law § 488](#)[2][d]); *see also* [22 NYCRR § 603.7](#)).

[FN6](#). That is not to say, however, that the issue may not be amenable to summary judgment in an appropriate case.

[FN7](#). The Trust also seeks the attorneys' fees it paid and costs it expended pursuing Love Funding, as well as its fees and costs related to the Arlington Apartments foreclosure and its lawsuit against Cyrus and its principals.

[FN8](#). We express no view as to whether the Love MLPA obligates Love Funding to indemnify the Trust for legal fees UBS incurred defending itself against the Trust, prior to the assignment. Although UBS purportedly spent over \$30 million defending itself against the Trust, counsel for the Trust stated at oral argument before this Court that the UBS legal fees sought by the Trust amount to some \$300,000, for representation relating to the Arlington Loan. We have not been asked whether these are "reasonable attorneys' fees" arising from or related to Love Funding's breach, within the meaning of the Love MLPA.