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Litigation Funding

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Introduction to Litigation Funding

What is commercial litigation funding?

- i. Litigation finance is a financial tool based on the value of legal claims as assets
- ii. It is the process by which a litigant (or a law firm) obtains financing to cover all or a portion of their litigation fees and expenses, and possibly, other amounts
- iii. A third party unrelated to the lawsuit provides capital to a plaintiff involved in litigation in exchange for a portion of any financial recovery from the lawsuit
- iv. Litigation finance is generally non-recourse, so if a case is not successful, the litigant owes nothing to the funder



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Use of Litigation Funding in Bankruptcy Proceedings



Litigation funding can be used by bankruptcy estate representatives and litigation trustees for:

- Pre-litigation and pre-confirmation investigations
- Working capital
- Fees and costs for post-petition litigation funding
- Monetizing judgments and appeals



Litigation funding can be used by law firms for:

- Full or reduced hourly fee funding
- Risk sharing in single cases and risk sharing in portfolio of cases
 - Funding is non-recourse to other partnership assets
 - Multiple contingency cases can be cross-collateralized

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Use of Litigation Funding in Bankruptcy Proceedings

Potential recipients of litigation financing in bankruptcy and distress situations include:

- Debtors
- Chapter 7 and 11 trustees
- Post-confirmation liquidating/litigation trustees
- Receivers or assignees (ABCs)
- Creditors' committees
- Legal counsel and financial advisors to the above



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Bankruptcy Claims Suitable for Litigation Funding

- D&O insurance coverage disputes
- Breach of fiduciary duty claims
- Article 5 avoidance litigation
 1. Fraudulent conveyances
 2. Preferences
 3. Turnover
- Inter-creditor and lien investigations and disputes
- General commercial disputes
 1. Breach of contract
 2. Intellectual property
- Tort claims
- Investigations and claim deployment
- Tax recovery actions



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The Features of Commercial Litigation Funding

- A contract between the client and funder (unless the party seeking the funding is a law firm)
- Usually non-recourse
- Amount and form of recovery may depend on the length of the case and/or amount of recovery
- Extensive due diligence is required (which impacts privilege issues)
- Expressly disclaims control/decision making authority

Commercial litigation finance is different from consumer litigation finance

Litigation funding is **not**:

- Insurance company retained defense counsel relationship
- A loan, it is typically a non-recourse investment

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How the Litigation Funding Process Works

Timeline of process and key steps:

- i. Non-disclosure Agreement
- ii. Term Sheet
- iii. Due Diligence/Exclusivity Period
- iv. Negotiation and Execution of the Litigation Funding Agreement
- v. Funding
- vi. Information and Consultation Rights during Litigation
- vii. Distribution of Proceeds from Settlements and/or Judgement



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Process, Procedures and Considerations Unique to Bankruptcy Proceedings

- i. Need for greater transparency during a bankruptcy
- ii. Multiple parties in interest involved
- iii. Funding terms may be scrutinized and subject to higher/better bids from other constituents (DIP lender, pre-petition lender, other creditors)
- iv. Court approval is required unless the funding is post confirmation where a litigation trust is set up and the trust agreement provides otherwise
- v. Section 363 vs Section 364

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Examples and Noteworthy Decisions

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SmileDirectClub, Inc., No. 23-90786 (Bankr. S.D. Tex. filed Sept. 29, 2023):

The Chapter 7 trustee overseeing SmileDirectClub's liquidation sought court approval to secure litigation funding to pursue claims against company insiders. However, a Texas bankruptcy judge denied the trustee's request. Even though the funding was not approved, this example highlights the trustee's proactive effort to use litigation funding as a tool to recover value for creditors in a complex liquidation scenario.

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In re: MLCJR, LLC (Cox Operating LLC):

In connection with its Chapter 11 proceedings, Cox Operating—a privately held oil and gas company and one of the largest independent operators in the Gulf of Mexico—undertook a court-supervised process to monetize a significant litigation asset: a \$200 million claim arising from a 2020 collision between the M/V Atina tanker and one of its offshore platforms. With the assistance of Moelis & Company and other advisers, Cox structured a competitive sale of the litigation under Section 363 of the Bankruptcy Code, identifying legal finance as a means to unlock immediate value for creditors. Burford Capital emerged as the stalking horse bidder and ultimately prevailed at auction with a \$26 million offer for 85% of net litigation proceeds. Although the case settled for \$45 million shortly after the auction—rendering the litigation finance transaction unnecessary—Burford was awarded a breakup fee for its role in establishing a market-tested floor value. The process demonstrated that litigation assets, often overlooked in insolvency scenarios, can be strategically monetized to generate material recoveries for stakeholders.

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Examples and Noteworthy Decisions (cont.)

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In re DSI Renal Holdings, LLC, 574 B.R. 446 (Bankr. D. Del. 2017):

In this Chapter 11 case, the liquidating trustee sought approval for a litigation funding agreement to finance an adversary proceeding against Valley National Bank. The agreement stipulated that the funder would cover the trustee's professional fees and expenses in exchange for a portion of any litigation recovery. The bankruptcy court approved this arrangement under Section 364 of the Bankruptcy Code, despite objections regarding potential conflicts of interest.

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In re Dean, No. 17-20259 (Bankr. S.D.W. Va. Jan. 5, 2018):

In this case, the Chapter 7 trustee entered into a litigation funding agreement with Reticulum Management LLC to advance up to \$200,000 for pursuing claims on behalf of the estate. Although the debtor later challenged the funding arrangement, the Fifth Circuit held that the debtor lacked standing to contest the court-approved funding agreement. This example shows how courts have upheld such arrangements to help estates pursue meritorious litigation when internal funds are insufficient.

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Funding Structures and Economics

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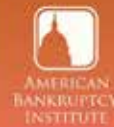
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Common Types of Funding Arrangements

1. Single Case Funding:
 - i. Lawyer is paid a percentage of current fees, then gets repaid deferred amounts (plus) from the resolution proceeds
 - ii. Litigation funder gets a multiple on its invested capital or a percentage of the litigation proceeds
 - iii. Litigant receives balance of the litigation proceeds
 - iv. Waterfalls will vary by deal and funder
2. Portfolio Funding:
 - i. Law firm uses contingent interests in multiple cases to secure funding



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Litigation Funding Valuation Considerations

Probability weighted analysis considering the following factors:

- i. Legal merits (strength and type of claim, defenses, legal or factual interpretation)
- ii. Procedural posture (prefiling, discovery, MTD, MSJ, pretrial)
- iii. Cost and fee structure (claimant, law firm and funder risk sharing)
- iv. Quality and quantum of damages (out of pocket losses versus lost profits)
- v. Recoverability and enforcement (defendants' ability to pay)
- vi. Duration to resolution (cash out to cash in, probability of settlement or appeal)
- vii. Jurisdiction (federal versus state courts)
- viii. Quality of counsel and experts
- ix. Client motivations and expectations

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Ethical and Professional Responsibility Considerations

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Legal Considerations

- Champerty
- Maintenance
- Usury



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Other Professional Responsibility Considerations

- Advising a client about commercial litigation funding
- Conflicts of interest
- Protecting the attorney's independent professional judgement
- Considerations relating to disclosures



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Best Practices

- i. Familiarize yourself with local laws, rules and ethical decisions
- ii. No attorney-client privileged material should ever be disclosed during due diligence or any other time
- iii. Enter into a non-disclosure agreement prior to engaging in substantive discussions
- iv. In jurisdictions with statutory prohibitions on champerty and maintenance, review case law regarding how those statutes are applied
- v. Work with funders that are aware of privilege and work product issues
- vi. Review Local Rules regarding mandatory disclosure



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Questions



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Faculty

Leah M. Eisenberg is a partner with Pashman Stein Walder Hayden P.C. in Hackensack, N.J., where her practice encompasses corporate reorganization, bankruptcy and default matters, corporate trust default matters, intercreditor matters, bankruptcy litigation, cannabis-related financing matters and cross border representations. She represents debtors, creditors, indenture trustees, committees of unsecured creditors, debtors, secured creditors, lenders, bidders and acquirors. Ms. Eisenberg has dedicated many *pro bono* hours to advising clients referred by Her Justice. She recently represented a synagogue in a proceeding in the Beth Din (Jewish Court) on employment, real estate and nonprofit matters. She also represented clients in obtaining for them Holocaust reparations from France, and she represented a nonprofit Holocaust education organization on corporate, employment and cross-border matters. She also volunteers at her synagogue and assists students and adults with reading Hebrew. Prior to joining Pashman Stein, Ms. Eisenberg worked at Mayer Brown LLP and Foley & Lardner LLP. Earlier in her career, she served as a first law clerk to Hon. Robert E. Gerber, U.S. Bankruptcy Judge for the Southern District of New York. She was included in *The Best Lawyers in America* for Bankruptcy and Creditor/Debtor Rights/Insolvency and Reorganization Law from 2019-22, and in 2018 she received the NYIC Women's Division Executive of the Year Award. Ms. Eisenberg is a board member of the Association of Insolvency Restructuring Advisors (AIRA), a co-founder and former president of the Women's Division for the New York Institute of Credit (NYIC), and an advisory board member of ABI's and AIRA's VALCON Conference. She is also a board member of The Bankruptcy Inclusion, Diversity, Equity & Accessibility Consortium. Ms. Eisenberg received her B.A. *summa cum laude* in 1997 from Binghamton University and her J.D. in 2000 from Brooklyn Law School.

Kenneth Epstein, CIRA, CDBV is an investment manager and legal counsel at Backlit Capital Solutions in New York, where he is responsible for leading the company's initiatives in bankruptcy and insolvency-related matters. He serves as a resource for debtors, creditors (including hedge funds, private-equity funds and alternative asset managers), bankruptcy estate representatives and other stakeholders seeking to maximize the value of litigation claims. Mr. Epstein has experience advising and managing debtors-in-possession, individual creditors and creditor groups (ad hoc and official committees) and financial institutions in insolvency and bankruptcy-related litigation matters nationally and internationally. He began his career as a lawyer in the financial restructuring group of Cadwalader, Wickersham & Taft. Prior to joining Backlit Capital, he was managing director in the restructuring and remediation group at MBIA, a publicly listed financial institution. Mr. Epstein has taught bankruptcy law as an adjunct professor at Cardozo Law School and has served as a panelist and author on bankruptcy-related topics. He is named in *Who's Who Legal: Thought Leaders – Third Party Funding Guide* (2020-21) and in *Lawdragon Global Restructuring Advisors & Consultants Guide* (2020). Mr. Epstein received his J.D. *cum laude* from Brooklyn Law School in 2000, where he served on the *Journal of Law and Public Policy*.

Peter R. Morrison is a partner with Squire Patton Boggs in Cleveland and has a broad and versatile corporate, litigation and finance practice built on experience representing and counseling clients in matters related to corporate and municipal insolvency. His clients have included private-equity and credit funds, corporate debtors, boards of directors, universities, municipal bond issuers, indenture

trustees, creditors' committees, and secured and unsecured creditors in transactions, reorganizations and liquidations nationwide. Ms. Morrison has significant bankruptcy litigation experience focused on dischargeability contests, declaratory judgment actions, director and officer liability suits, and the prosecution and defense of avoidance actions. His insolvency and restructuring practice is bolstered by his banking and debt-finance experience, which has included the negotiation, documentation and management of secured and unsecured loan transactions, including securitizations, syndicated credit facilities, unitranche facilities, split collateral pool transactions and bridge financings. Mr. Morrison received his B.A. in 2004 from the University of Wisconsin - Madison and his J.D. *cum laude* in 2009 from Case Western Reserve University, where he was a member of the Order of the Barristers and executive notes editor of the *Health Matrix - Journal of Law-Medicine*.

Deirdre A. O'Connor is managing director on the Corporate Restructuring team of Epiq in New York, with a focus on business development. With more than 30 years of restructuring experience in law, government, corporate finance and technology-enabled legal solutions, she focuses on enterprise-wide initiatives to strengthen and expand the company's law firm and corporate client relationships. Ms. O'Connor has several years of experience in the leveraged finance industry and serves on corporate boards and post-confirmation oversight committees. She also served as the U.S. Trustee for the Southern District of New York and oversaw the administration of some of the largest bankruptcies in history. In addition, she served as an Assistant U.S. Attorney for the District of Connecticut in both the civil and criminal divisions. Ms. O'Connor is active in many restructuring organizations. She was the inaugural recipient of IWIRC's Women of the Year in Restructuring and has received the St. Francis Service Award by Catholic Renewal of Catholic Charities of Greater New York. An ABI member, she serves as an advisory board member for its Health Care Program and New York City Bankruptcy Conference. She is also an adjunct professor at St. John's University School of Law's LL.M. in Bankruptcy program. Ms. O'Connor received her B.A. from New York University and her J.D. from Quinnipiac University School of Law.