AMERICAN BANKRUPTCY INSTITUTE

2017 Bankruptcy Battleground West

Litigation Toward Settlement: Questions and Strategies in Bankruptcy Litigation

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CONCURRENT SESSION

2017

LITIGATION TOWARDS SETTLEMENT

Questions and Strategies in Bankruptcy Litigation

Panel: **Honorable Scott C. Clarkson, United States Bankruptcy Judge for the Central District of California**

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Moderator: **Kyle Everett, Senior Managing Director, Development Specialists, Inc.**

"Statistics show that well over 95% of all litigation settles." (ABI Journal, Mediation of a Bankruptcy Case).

This means that planning for a pre-trial settlement is a crucial component of any sound legal strategy.

1. **Benefits of Settling a Case**

- **Costs.** Litigation is very expensive for all parties. Pleadings get filed, hearings are attended, written discovery is propounded and responded to, depositions are conducted, experts are retained and preparation for trial, trial and subsequent appeals all cost a lot of money for parties and the bankruptcy estate. If a case settles before going to trial, many of these expenses can be significantly reduced or eliminated altogether. The earlier in a proceeding that a settlement is reached, the more cost savings are achieved, especially considering the time value of money.

- **Stress**. Litigation is a stressful endeavor. Parties are faced with unfamiliar rules and playing surface. Uncertainty as to the process and outcome of proceedings are stressful not only for clients, but the professionals as well. Having to prepare for testimony at depositions and trials can be a huge emotional burden for some.

- **Privacy**. It is said that being in a bankruptcy proceeding is akin to being inside a fishbowl where most financial and many personal matters are on display and available to the public. When litigation is commence and pleadings are filed, unless sealed, the information is also available to the public. This includes company financials, internal communications, emails and, yes, text messages. An early settlement will likely keep private information out of the public light.

- **Certainty and Finality.** All lawyers know that it is extremely difficult to predict how the court may rule and the outcome of the proceeding. This is made more complicated by the uncertainty of all testimony which may be presented at trial. A settlement, on the other hand, allows the parties to be placed in charge of the outcome of the dispute and, importantly, results in certainty and finality of conclusion of the proceeding without the need for further litigation or appeals.

- **Focus**. In any litigation matter, both sides consume valuable resources other than money in connection with managing the case. Any non-routine litigation matter uses the time and focus of many members of management as well as staff for discovery and witness preparation that could otherwise be focused on the profitable operations of the business. Additionally, depending on the importance of the case, staff members or key employees can be fixated on the outcome and how it might affect them personally, which may cause the company to lose people prematurely or at the very least, perform poorly.

2. **Bankruptcy litigation and contested matters differ from non-bankruptcy litigation**

A. Generally fast-paced before the presiding bankruptcy judge without a jury.
   i. Not a lot of time to investigate and understand all facts and nuances.
   ii. Due to the time constraints, generally require immediate and extensive action to brief and prepare issues.
   iii. May be a benefit since most judges are more business savvy than jurors.

B. Recovery often may be limited to value of estate with parties competing over a finite pie.
   i. The higher the administrative costs, which are entitled to priority, the smaller the pie for the parties.
   ii. Costs of litigation may be at expense of estate - A party who is funded by the estate with limited or no risk of a cost reward against it if unsuccessful may feel empowered to take a more aggressive position in litigation and resist settlement.
      1. Fee Application process and review by constituents and the court.
      2. Fees and costs of professionals defending fee application objections may not be compensable by the estate (*Asarco*).

C. Multiple parties and constituents.
   i. Debtor, creditors, committees (ad hoc and official committees).

D. The interests, motivations and agenda of parties may be different depending on whether the case is a reorganization (where future business relationships are relevant) or a liquidation.

E. Results are generally dollar driven (rather than emotional).

F. Important Issues (to avoid bad precedent) - A party for whom the issue in question is a matter of significant importance within its industry or practice may, in some cases, be more inclined to settle to avoid a bad precedent, or in other cases be more inclined to pursue it more forcefully in the hopes of establishing the ‘right’ precedent.

3. **Factors to Evaluate Settlement Value**[1]

A. Litigation costs

B. Inconvenience and interruption to business

C. Potential publicity and damage of reputation (both internal and external)

D. Value of ongoing relationship to other party

I. Consider claim purchasers, and having less incentive to foster relationship

II. Liquidation vs. restructuring

E. Value of payment now vs some time in future (Time Value of Money)

I. Case complexity

II. Who pays (i.e., estate/contractual clauses)

F. Commercial considerations (interference with sale, merger, other business objective)

G. Existing case law or lack thereof

H. Expected outcome of litigation

I. Understand the facts and the applicable law

[1] Source: Belknap, Jr., Calculating Settlement Value of a Case

4. Pre-Litigation Case Assessment and Settlement Efforts

A. Meet with client

B. Understand the facts

I. Don't simply rely on client statements. Review contracts, documents, correspondence to understand the true facts rather than potentially biased facts as presented by client.

II. Interview others to gain their understanding of the facts

C. Understand the law and how it applies to your facts

D. Estimate the cost to litigate the case through various stages:

I. Motion to Dismiss

II. Discovery

III. Summary Judgment

IV. Trial

V. Appeal(s)

E. Determine range of possible recovery

F. Determine collectability of possible judgment

G. Decision Tree (value of the case)

I. Decision Tree is a tool used to value the multiple financial outcomes possible in any litigation

II. Example:

H. Once litigation is commenced, costs increase substantially. Provided that you have sufficient information to evaluate claims, settlement efforts are important and may result in a quick and efficient resolution of the dispute.

5. **Filing Complaint and Post-Litigation Actions**

A. When pre-litigation settlement efforts are unsuccessful, litigation may be commenced.

B. Venue - Determine where the lawsuit will be filed

I. Debtor in Possession or Trustee is not limited to litigation before the bankruptcy court where the case is pending.

II. In some instances (i.e., avoidance actions in Central District of California), the DIP or Trustee is required to litigate claims in the jurisdiction of the target party.

C. Since it is not always possible to ascertain all twists and turns before a case is commenced, it is important for the professional team and client to not simply focus on litigation, but continue analyzing information as it is obtained and continue modifying and updating the Decision Tree to be informed as to the updated value of the claim (or defense) to facility negotiations and settlement discussions.

I. An attorney should be thinking about settlement every time that he/she picks up a litigation file.

D. Settlement Options

I. Arbitration

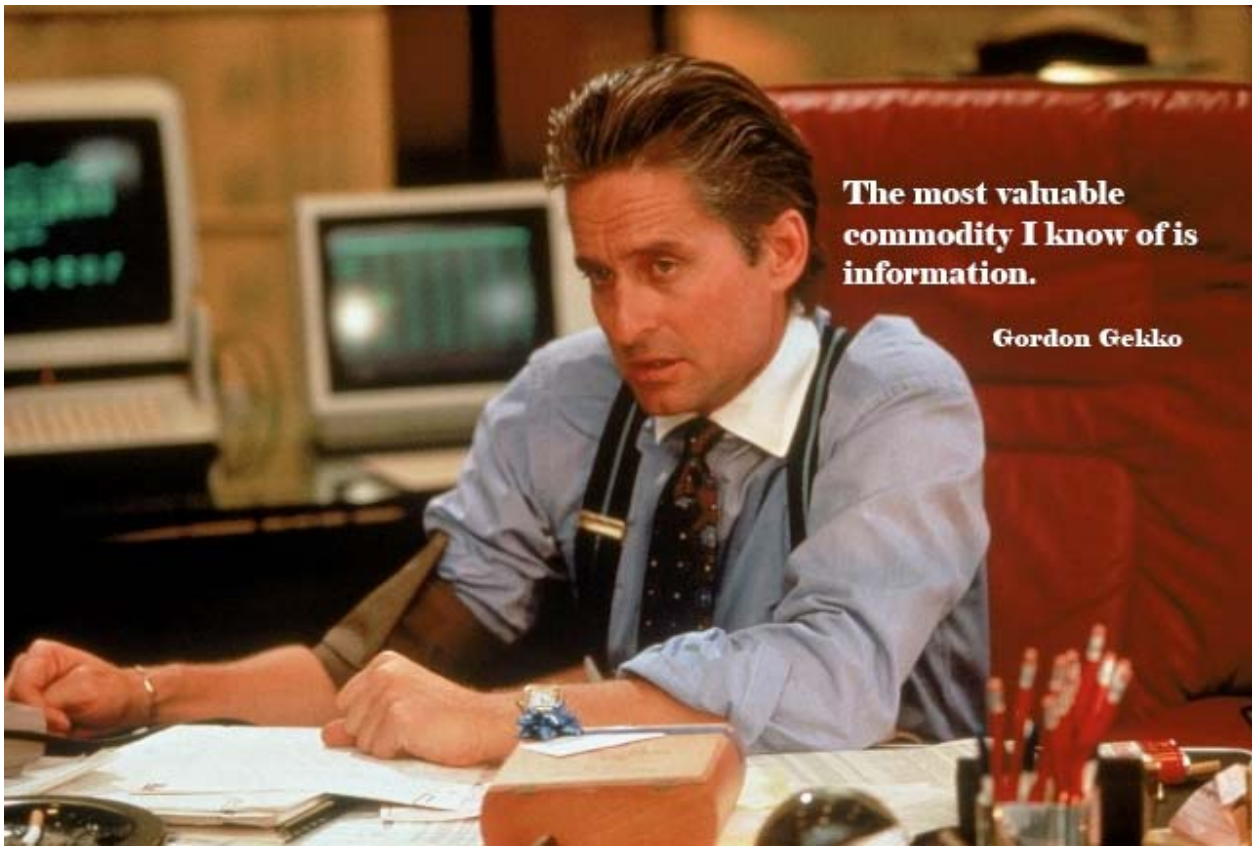
II. Mediation

a. Bankruptcy Mediation Program
b. Sitting and retired judges
c. Other professionals with unique expertise as to issues presented

III. Informal settlement conferences among professionals with or without clients

IV. If practical, meeting among the business people to resolve business deals

E. However, in order to be informed and make appropriate decisions for settlement or litigation, you need . . .



Wall Street. Directed by Oliver Stone. 1987. Twentieth Century Fox.

6. **Sources of Information**

A. Informal Discovery/Investigation

- Client documents (including electronic communication).
- Investigation and research from public sources.
- Informal settlement conferences with opposing side, including exchange of documents (similar to exchanges under Fed.R.Civ.P. 26).

B. Formal Discovery

- It is not always feasible to gain access to all information before litigation is commenced, such as cooperative exchange of information with the adverse party. Litigation – through discovery – provides parties with a powerful took that forces the exchange of information.
  - Initial exchanges and disclosures per Fed.R.Civ.P. 26
  - Requests for Admissions
  - Interrogatories
  - Requests for Production of Documents
  - Depositions
  - Third party subpoenas

C. Motion Practice

- Preparing and filing a motion forces a party to think about and gather information in support of its claim.
  - A motion to dismiss forces the moving party to consider the facts and the applicable law to such facts in connection with seeking the relief requested. The

responding party is forced to consider the moving arguments and take another look at the case to respond thereto.

  - A motion for summary judgment requires the moving party to prepare a detailed statement uncontroverted material facts and proposed conclusions of law, which forces the party to again look at the case to assess its merits and, consequently, its value.

- Motion practice shows the parties' understanding of the facts and their litigation strategy.
- The extent of the motion practice, including quality and detail of the briefs, provides some insight into how committed a party is to the case and the kind of resources they are willing to expend on the litigation.
- As important, and even more important, is gauging the court's thoughts on the facts and the merits of the litigation. This information becomes available not only based on the court's ruling, but also the comments made by the court at the hearing.

7. **Use of an expert in litigating towards settlement**

A. The court appointed neutral – making sure both parties are equally unhappy

i. Controlled costs

ii. No need for opposing expert reports and rebuttal reports – one strand of opinions and one set of findings

iii. Already vetted and approved by the Court

iv. If neutral not appointed, may consider discussions between experts to narrow certain issues - potential to remove uncertainty in methodology between expert.

B. Roles of Experts:

i. Helping to develop and keep sight of client's endgame

ii. Working with counsel and client to develop effective litigation and settlement strategies

iii. Avoiding pointless litigation – i.e. an award from a company that is in financial distress

iv. Third party provider and evaluator of data

v. Independent, neutral and impartial in their relationship to the parties, issues in dispute and the data they provide

vi. Answerer of factual questions

vii. Reducer of data conflicts which prevent parties from arriving at agreed upon position

viii. Needs to be flexible (but not malleable with regard to professionalism) and able to adjust calculations and other findings during course of litigation as different scenarios and facts may emerge

ix. Provide an external viewpoint that may not have been considered by parties to the matter
x. Important when key areas of a litigation matter are known to be covered by expert evidence
xi. Providing critical assessment of the facts and assumptions underlying the claims
xii. Provide trier of fact and other parties with data to resolve differences and help move toward settlement
xiii. Providing input that helps parties focus energies and costs on matters that provide the greatest benefit and least risk.
xiv. Provide third-party, unemotional perspective that may help move a legal logjam by demonstrating that an intractable position has the least financial benefit
xv. Early preparation of an expert report and testimony at deposition can provide demonstrative evidence to opposing party that their case may not be as strong as they think
xvi. Managing client's and counsel's understanding of findings from expert evidence and setting realistic expectations
xvii. Taking away some of the emotion from the litigants (and lawyers) and demonstrating that the costs of litigation do or do not exceed the potential benefits
xviii. Presenting arguments in a number of different ways facilitates discussions and negotiations
xix. Explaining claims in plain language and providing opinion as to the true financial stakes of the litigation

2. Qualities to look for in your Expert:
    A. Specialist industry expertise
    B. Ability to bring and maintain an impartial view of the litigation
    C. Analytical skills and an "investigative" mindset
    D. Ability to understand complex scenarios and prepare related calculations
    E. Ability to present findings in a succinct and user friendly manner
    F. Ability to adapt during course of litigation
    G. One who looks to add value to the case
    H. One who has a skeptical mind and does not blindly accept information presented
    I. An expert who understands the benefits of settlement to his or her client
    J. Strives to retain objectivity
    K. Presents information that client may not want to hear, but may be essential to not waste resources on lost causes
    L. Provide meaningful input at all stages of litigation
    M. Effective management of costs while still providing high level work product
    N. Avoid "hired guns" and the perception of imbalanced expert reporting
    O. An unqualified expert can be more impactful on the success of litigation than a qualified one

3. Potential Expert services during litigation towards settlement process
    A. Provide independent assessment of the amount in dispute
    B. Assist parties with understanding complex financial and accounting issues
    C. Estimate for plaintiff potential recoveries and wherewithal of defendant to pay
    D. Advise defendant on range of potential losses based on fact patterns and underlying assumptions.
    E. Prepare "what if" models on range of outcomes and incorporate into decision trees
    F. Estimate costs of litigation and prepare cost/benefit analyses
    G. Help with budgeting for litigation
    H. Help with developing reasonable/tolerable settlement amounts
    I. Calculate damages and economic losses (historically and prospectively)
    J. Business valuation
    K. Provide perspective on potential pitfalls and vulnerabilities from opposing evidence
    L. Prepare expert report
    M. Prepare rebuttal report
    N. Attend opposing expert's deposition
    O. Assist counsel with developing discovery requests and provide other support in motion practice
    P. Discounting future losses
    Q. Determining present value of future cash flows
    R. Assessing tax implications of settlement scenarios

4. Evaluating costs of litigation for cost/benefit analysis
    A. Legal and other professional fees
    B. Reimbursable expenses
    C. Third party legal fees
    D. Costs of bad publicity
    E. Wasted management time
    F. Disruption of normal business activity
    G. Litigation gamesmanship - motion practice
    H. Discovery requests and eDiscovery
    I. Investigations
    J. Depositions
    K. Estimating other resources needed
    L. Scope creep

Consulting v. Expert Witness

1. Consulting Witness
   - A. Privilege/Work Product
   - B. Can take an advocacy position and help counsel develop scenarios, ranges/likelihood of outcomes, and other less balanced litigation consulting
   - C. Subsequent Designation As Expert Witness
     - i. If a consulting witness is later designated as an expert witness, all of the work and communications created as a consulting witness becomes discoverable. Further, a consulting expert's knowledge of the litigation strategy could potentially be discovered and used against him or her once designated.

2. Expert Witness
   - A. Assists with reducing litigation costs by identifying relevant information that should be disclosed or analyzed.
   - B. Can work tactically with counsel to assist with the progression of the litigation and approach to settlement.
   - C. Can help with controlling freewheel spending and other non-productive activities.