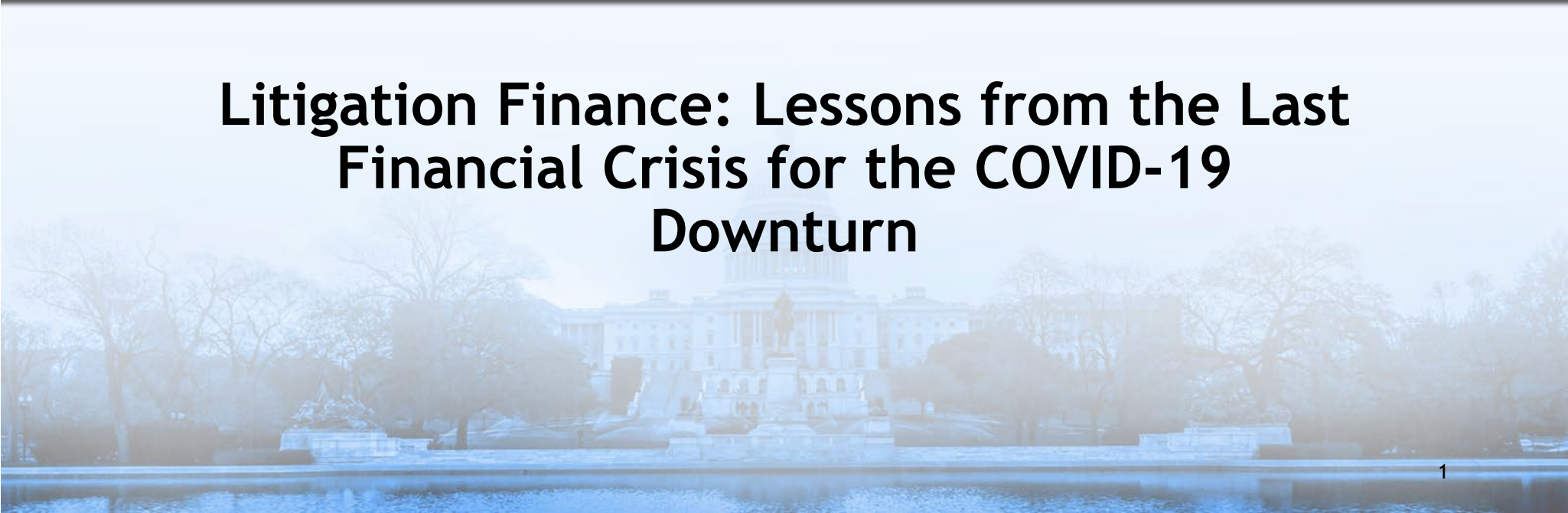




abiLIVE
webinar series

Litigation Finance: Lessons from the Last Financial Crisis for the COVID-19 Downturn



Introductions



Emily Slater

Managing Director, Burford Capital

- Responsible for assessing and underwriting legal risk across a broad range of practice areas and for identifying high-value investments in the marketplace.
- Prior to Burford, Emily was a litigator at Debevoise & Plimpton, where she specialized in complex securities and other bet-the-company litigation and regulatory investigations.
- Emily speaks frequently about legal finance in the media and at events, including those organized by AIRA, the American Bar Association, ICCA, NYSBA and The Knowledge Group.

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Introductions



Eric Fisher

Partner, Binder & Schwartz

- His practice focuses on bankruptcy litigation and other complex commercial disputes
- Mr. Fisher has handled numerous high-stakes bankruptcy litigations, including serving as special counsel to the creditors' committee in the General Motors bankruptcy proceedings and as plan administrator in the bankruptcy proceedings of DPH Holdings Corporation (formerly known as Delphi Corporation).
- Eric has served as lead counsel in bench and jury trials in the Southern District of New York and other trial courts; argued numerous appeals before the Second Circuit and other appellate courts, including successfully arguing an issue of first impression before the Delaware Supreme Court; and litigated cases in a variety of alternative dispute resolution forums, including AAA, JAMS and FINRA. .

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Introductions



Cathy Reece

Director, Fennemore Craig, P.C

- Cathy serves as a director in the Financial Restructuring, Bankruptcy and Creditors' Rights Practice Group.
- She has represented secured lenders and unsecured creditors in large chapter 11 cases such as MicroAge, Einstein Bagel, Boston Chicken, Foster Grant, UDC Homes and in numerous real estate cases involving shopping centers, apartments, office buildings, mines and health care facilities.
- She is listed in Best Lawyers, Super Lawyers, and Benchmark's Top 250 Women in Litigation, and has been named one of the Most Influential Women in Arizona Business.

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Introductions



Marc S. Kirschner
*Senior Managing Director, Goldin Associates,
LLC*

- Marc has been an advisor and court appointed trustee in major bankruptcy matters, including Millennium Health Litigation Trusts, Nine West Litigation Trust, Refco and Tribune.
- Before becoming a consultant, Marc was a Managing Director, the Chief Operating Officer and the General Counsel of Resurgence Asset Management LLC, a distressed debt investment management company.
- Marc is a fellow of the American College of Bankruptcy.

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- Bankruptcy professionals in bankruptcies arising out of the 2007-2008 financial crisis pioneered the use of specialty third party litigation finance for bankruptcy-related litigation
- Today's case studies illustrate key issues regarding use of litigation finance in bankruptcy-related litigation as we approach a new downturn:
 - Trust agreement or other authorization for use of litigation finance
 - Duty to ensure best deal for creditors (market testing)
 - Necessary approvals from the court, creditors
 - Ethics issues - confidentiality and control
 - Bankruptcy code and rule pathways and limitations



The Great Recession 2007 – 2008

◆ 1. Causes

- Housing Market Bubble
- Predatory Private Mortgage Lending
- Subprime Mortgage Crisis
- Stress in World-wide Financial System

◆ 2. Impact

Huge Increase in Bankruptcies



Corporate Frauds Unveiled



◆ 3. Strong World-wide Recovery 2010 – 2020

- Dow Jones Peak: \$29,551 – February 12, 2020
- S&P 500 Peak: \$3,386 – February 19, 2020



What to expect: COVID-19 Disaster

◆ 1. Causes

- Coronavirus
- World-wide Shut Down
- Humanitarian Crisis
- Global Supply Chain Disruption

◆ 2. Impact

Dramatic Impact Q2 to Q4 2020

- \$10.1 trillion corporate debt currently outstanding of which \$934 billion is distressed, compared with \$6.6 trillion in 2008, of which \$184 billion was distressed¹
- Unprecedented expected wave of bankruptcies
- Unprecedented expected wave of litigation
- New massive frauds may be unveiled

Entire Industries May Change Forever

Hotels
Airlines
Entertainment

Oil and Gas
Retail
Real Estate

◆ 3. Reduced Cash Flow Will Drain Litigation Budgets

◆ 4. Increasing Use of Litigation Funding

1. St. Louis Fed; Bloomberg; New York Times.

What is Third-Party Litigation Finance?

- Form of specialty finance that is based on the value of litigation
- Characteristics generally include:
 - Allows funded party to monetize litigation and creates a contingency relationship for the funded party
 - Non-recourse investment...*not* a loan
 - Proceeds fund costs of litigation (with possibility of funds for other purposes)
 - Used by businesses and non-corporate entities
 - Available at any point in the litigation lifecycle
 - Arrangement can be with funded parties or law firms
 - Funding is passive, funder has no control over litigation strategy or settlement
 - Funder communications and funding agreement protected from disclosure by attorney work product protection
- Most investments are bespoke, and the form and substance of deals can vary significantly

What is a Good Case for Litigation Finance?

- Meritorious litigation or group of litigations (portfolio)
- Law firm is experienced and has a successful track record and willingness to take case on partial contingency and share risk
- Case is supported by substantial evidence and legal precedent
- Litigation expected to result in settlement or judgment that is monetary or capable of being valued
- Damages are well supported and significantly exceed the requested amount of financing
- Defendants have an ability to satisfy settlement or judgment

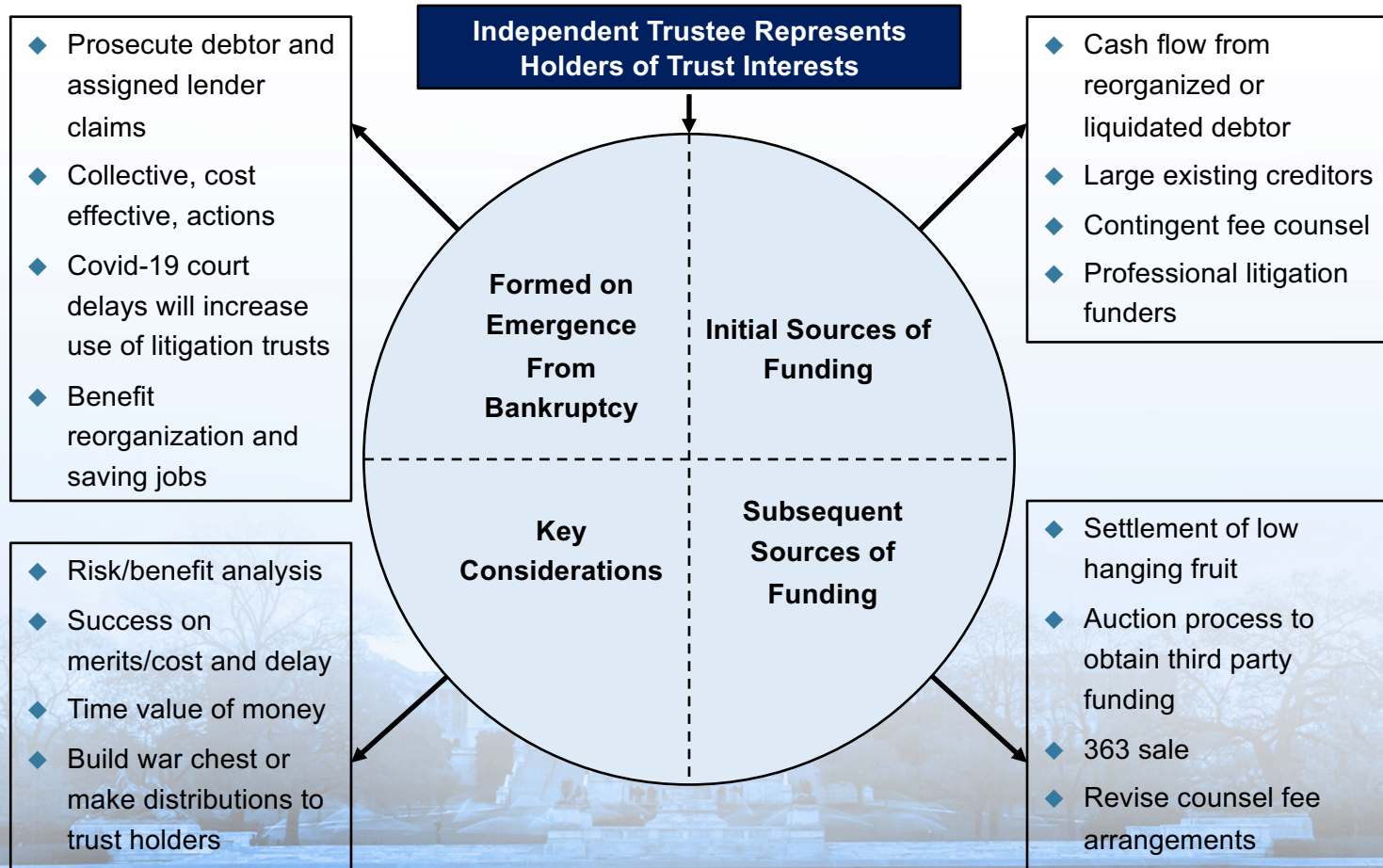
Litigation finance in bankruptcy

Uses of litigation finance in the bankruptcy context

- Finance for litigation trusts
- Finance for creditors
- Purchase of litigation claims
- Fund the pursuit of claims and causes of action by or on behalf of debtor estates



Litigation Trusts



Finance for litigation trusts

Non-recourse capital can help increase litigation trust recoveries

- Provide funding to litigation trusts with high-value claims
- Well suited to litigation trusts with multiple matters of varying levels of risk and duration
- If litigation trust fails to generate recoveries, financial burden remains with funder, not the trust beneficiaries
- Pricing can be negotiated by portfolio, but tied to recoveries
- Benefits
 - Provide capital for an underfunded litigation trust
 - Preserve cash recoveries for creditors
 - Accelerated and more efficient recoveries for creditors and estate beneficiaries
 - Capital can be used to fund administrative expenses

Finance for creditors

Non-recourse funding to creditors with high-value litigation assets

- Provide capital for litigation brought by a creditors' committee or creditors
- Generally, disputes over creditor seniority
- Purchase claims from creditors that may have liquidity constraints or are in wind-down
- Benefits
 - Inject capital where creditor is experiencing litigation fatigue or has reached credit limits
 - Accelerate monetization for creditor
 - Reduce risk for creditors
 - Allow professionals working for creditor or equity committee that are not able to bill their fees through an estate

Finance claims held by the debtor

Non-recourse capital to fund the pursuit of high-value litigation claims

- Provide funding to debtor estates to hire counsel of choice with the economic arrangement determined to be the most beneficial to the debtor/creditors
- Pay legal and professional fees and expenses (e.g., discovery, expert witnesses, and other professional services)
- In certain instances, pay administrative expenses
- Make distributions to creditors
- Benefits
 - Provide the prospect of an immediate liquidity event for creditors and/or the acceleration of creditor recoveries
 - Inject capital where capital is otherwise difficult to come by
 - Enable claims to be prosecuted and value to be realized
 - Reduce risk for estates and creditors

Purchase or manage litigation claims

Monetize high-value litigation claims

- Third party litigation finance providers can purchase a litigation claim outright, or the right to manage litigation of the claim
- Provides cash up front for the claim and takes on the management and expense of litigation
- Estate or trust can retain a “back-end” interest in any recovery
- Benefits
 - Provide the prospect of an immediate liquidity event for creditors and/or the acceleration of creditor recoveries
 - Eliminate risk for debtor estates and creditors

Funding a Litigation Trust- The GM Bankruptcy

Motors Liquidation Company Avoidance Action Trust v. JPMorgan Chase Bank, N.A., et al., Adv. Pro. No. 09-00504 (Bankr. S.D.N.Y.)

- Outcome: \$231 million settlement in favor of post-confirmation creditor litigation trust after nearly 10 years of litigation
- Successful outcome made possible by litigation funding
- Litigation funding for trust was approved by Bankruptcy Court

Funding a Litigation Trust- The GM Bankruptcy (con't)

Case proceeded in phases that helped clarify funding needs

- **Phase I:** summary judgment and appeals to Second Circuit/Delaware Supreme Court of liability question: whether JPMorgan's mistaken filing of a UCC termination statement with regard to \$1.5 billion term loan was legally effective to terminate perfected security interest
- **Phase II:** trial on 40 representative assets from among more than 100,000 automotive assets in dispute with regard to fixture/equipment classification and valuation method
- **Phase III:** intensive asset-by-asset mediation process to apply court decision from Phase II to remaining assets in dispute
- **Phase IV:** possible return to trial on further representative assets

Funding a Litigation Trust- The GM Bankruptcy (con't)

Funding needs were structured around phases of the litigation

- Trust was funded with \$1.5 million for a major fraudulent conveyance litigation against JPMorgan and hundreds of other financial institution defendants; this was barely adequate for Phase I (no expert expenses).
- Trust received a \$15 million round of interest-free funding from US/Canadian governments (DIP Lenders) for Phase II
- As the Trust neared the end of Phase II, its funds were exhausted (\$204,000 remained)

Funder provided \$15 million of private funding for the end of Phase II and for Phase III

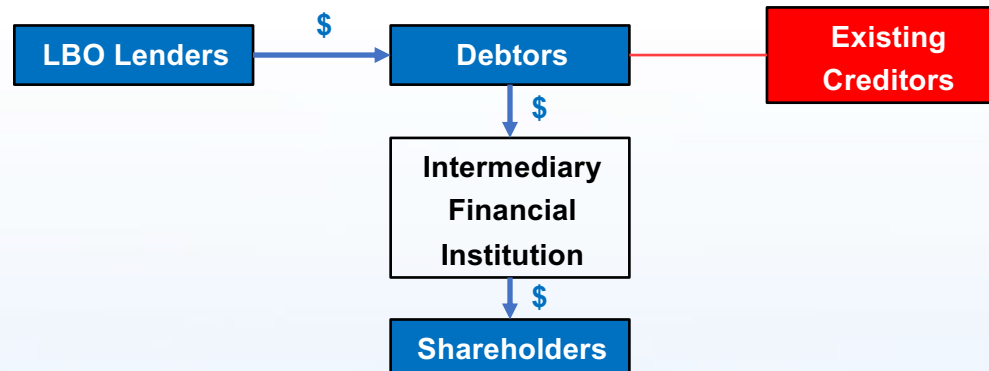
- A second private funder established a \$10 million facility to ensure the Trust had resources for potential Phase IV
- Case settled as the parties began ramping up for second trial in Phase IV

Funding a Litigation Trust- The GM Bankruptcy (con't)

Key features of funding process in the GM case and lessons learned

- Trust documents allowed for litigation funding
- Trust monitor (retired chief bankruptcy judge, SDNY) participated in process to secure competitive funding for trust
 - Return of money drawn plus 1.9x
 - Interest of 9%, only after 18 months
- Non-financial considerations are also important
 - Reputation of funder
 - Working relationship with funder
 - Independence of trust decision-makers
- Due diligence process assists case analysis and risk assessment
- Funding signals to defendants that trust is well-resourced and that risk-reward calculus supports funder's investment

Leveraged Buyouts (LBOs)



Existing Creditors Have Broad Power Under Federal and State Law to Avoid Transfers to Shareholders to Maximize Recoveries to Creditors

Intentional Fraudulent Transfers

- ◆ Actual intent to hinder, delay or defraud creditors
- ◆ Admissions or circumstantial evidence by demonstrating certain badges of fraud

Constructive Fraudulent Transfers

- ◆ Transfer when balance sheet or cash flow insolvent or has inadequate capital
- ◆ Receipt of less than reasonably equivalent value



Tribune Cases – Bankruptcy Code 546(e)

◆ 1. Safe Harbor Under Bankruptcy Code 546(e)

- Prevents **Trustee** from avoiding certain constructive but not intentional fraudulent transfers made **by** or **to** certain entities including a **Financial Institution**
- Purpose to prevent disruption in financial markets and protect integrity of securities settlements and clearance process

◆ 2. Definition of Financial Institution

- Bank or similar financial entity, including when such entity is acting as an **agent or custodian** for a **customer... in connection with a securities contract... then such customer**

◆ 3. U.S. Supreme Court Merit Management Case

- 546(e) does not protect **constructive fraudulent transfer** made through a **Financial Institution** serving merely as an intermediary to execute the transaction
- Look only to ultimate transferee
- **X** gives money to **Y** and directs **Y** to give money to **Z**
- **Z** is actual transferee and **Y** is disregarded intermediary used to execute the transaction
- Footnote is Merit invited future controversy
- ❖ Parties in Merit did not address definition of **Financial Institution**



Tribune Cases (cont'd)

◆ 4. District Court and Second Circuit Court of Appeals in Tribune

- Deem Tribune, a media company, a **Financial Institution** because as a **customer** it retained a **Financial Institution** as its **agent** to execute the transaction
- Theory so broad it will render any transfer non-avoidable unless done by walking \$\$\$ to the transferee

◆ 5. Petition for Review in U.S. Supreme Court

- Deprives Merit of any practical significance because large transfers are usually implemented by bank wires or checks
- Also seeking a ruling that individual creditors can sue outside bankruptcy under state law and will not be barred by federal pre-emption doctrine

Funding a Debtor: *In re MagCorp*

In re MagCorp, Case No. 01-14312 (Bankr. SDNY)

- Magnesium Corp of America (“MagCorp”), an operating subsidiary of Renco, filed for bankruptcy in 2001, eventually converting to a Chapter 7 liquidation
- In 2003, the MagCorp chapter 7 liquidation trustee initiated an adversary action against Renco for fraudulent transfer, fraudulent conveyance, breach of fiduciary duty and unjust enrichment, resulting in a \$213 million judgment after trial against Renco in 2015
- In 2016, with \$670,000 of cash left, the chapter 7 liquidation trustee executed a 363 sale of a right to MagCorp’s litigation proceeds if the judgment was sustained on appeal

Funding a Debtor: *In re MagCorp* (con't)

- Public auction generated \$26.2 million for MagCorp on a *non-recourse* basis
 - If the case had to be retried or lost on appeal, guaranteed recovery for creditors and war chest for further litigation
 - If case won, litigation funder would receive \$50 million plus interest
- Bankruptcy court approved transaction as reasonable and in the best interest of creditors
 - Court supported the rejection of an alternative offer by Renco
 - Court rejected objections of some noteholders that transaction was unnecessary and too expensive
- MagCorp's judgment was ultimately affirmed

What can go wrong: *In re Epicenter*

In re Epicenter Partners, Case No. 16-5493 (Bankr. Arizona)

- Pre-bankruptcy dispute between Epicenter (debtor) and CPF, an entity that purchased an interest in a litigation funding agreement entered into and funded pre-bankruptcy by Ganyemeade
- Epicenter filed adversary proceeding challenging the underlying litigation finance arrangement alleging:
 - Fraudulent conveyance
 - Equitable subordination
 - Recharacterization
- Epicenter also filed objections to proofs of claim
- Most of the disputes centered on how the parties acted and agreements the parties entered into *after* Epicenter's litigation was successful in the litigation that was funded
 - Disputes arose after Epicenter received distressed real property instead of cash damages at the end of the successful litigation that was the subject of the funding agreement
 - Epicenter alleged that the funder and law firm were bad actors

What can go wrong: *Epicenter* (con't)

- Court found grounds for possible equitable subordination of the claims of the attorneys for fees because, "Attorneys are fiduciaries with duties of loyalty, care and obedience, whose relationship with the client must be one of utmost trust."
- No grounds for subordination or unwinding of funding agreement rights to CPF - court found funding agreement and assignment enforceable
- Bankruptcy Court dismissed most of the adversary proceeding
- 9th Circuit Bankruptcy Appellate Panel affirmed Bankruptcy Court's decision to overrule the claim objections

QUESTIONS AND ANSWERS