



Litigation Finance in U.S. Bankruptcy

Woodsford Insight

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Debtors and creditors in bankruptcy often hold valuable claims but lack adequate capital to vigorously pursue them. Whether an estate is facing liquidity constraints or wants to establish a well-resourced litigation trust, or a group of creditors is considering potentially expensive litigation but has no (or limited) budget to support its bankruptcy strategy, litigation funding provides a solution to these problems.

Funders like Woodsford provide capital for fees and costs to pursue litigation, protect and enlarge claims, and maximize recovery or distribution (as the case may be), in exchange for a share of the eventual recovery. The funding is passive—meaning the funder has no decision-making authority in the litigation or bankruptcy case—and non-recourse—meaning the funder receives its deployed capital and return only if the litigation results in a recovery or the creditor receives a distribution in the course of the bankruptcy case.

How Funding is Deployed in Bankruptcy-related Contexts

Debtors and creditors can use litigation funding to pursue their claims at no upfront cost to the funded party. The funder assumes the financial risk of loss. For the debtor, this means that there are generally no litigation expenditures to deplete the estate or to weigh against a potential recovery for estate claims. Funding, therefore, provides an additional solution for the debtor with valuable litigation assets but minimal cash to exercise its fiduciary duty to maximize the estate for the benefit of its creditors.

Similarly situated creditors may face a situation where their claims collectively hold ample value, but on an individual basis are too costly to pursue without additional resources. In such situations, creditors may join together on an “ad hoc” basis to pursue their claims. Just as ad hoc groups can retain legal counsel and financial

professionals, ad hoc groups can seek litigation funding. Woodsford provides funding to individual creditors and groups of creditors (formal and ad hoc) to cover the professional fees and costs necessary to maximize recovery.

Funding can fundamentally transform a gridlocked and seemingly dead-end situation and offers a risk and cost free pathway to potentially multi-million dollar returns for both debtors and creditors.

Woodsford’s expertise with both bankruptcy litigation and litigation finance allow us to work with you to fund creative solutions to capital constraints facing parties in bankruptcy. Below is a description of some of the many different financing structures available to debtors and creditors, and a discussion of their benefits.

Litigation Finance Solutions for Bankruptcy Stakeholders

As noted above, litigation funding is passive and non-recourse. This means the funder lacks decision-making authority over the litigation and receives its capital and return only if the litigation resolves in the funded party’s favor. The latter feature distinguishes litigation finance from traditional lending. Moreover, by sourcing capital from a third party, parties can vigorously pursue their claims without depleting estate resources, whether directly or indirectly, in situations where the estate would otherwise pay a creditor group’s fees. The following are examples of financing structures and their benefits.



Debtor-Side Funding Structures

Funding is available for cash-strapped estates or trusts with litigation assets. Funding for debtors can take a number of forms, some of which are described below:

Litigation Trusts

Litigation trusts always require a source of funding to pursue recovery for the benefit of certain creditors who might otherwise end up with little or nothing in the course of a bankruptcy, particularly where the claims may otherwise be subject to a release. In this structure, instead of using funds from the estate, a funder provides capital to cover the fees and costs of the litigation trust. If the trust successfully pursues its claims, the funder receives its deployed capital along with a pre-negotiated portion of the recovery. If the trust is unsuccessful, the trust owes the funder nothing. Funding is available for trusts on a claim-by-claim or portfolio basis, and may be provided at the outset of the creation of the litigation trust or at a later date (for example, if a trust has depleted existing capital or has uncovered additional claims but has an insufficient budget to pursue them).

As courts and Congress scrutinize and circumscribe the availability and scope of non-consensual third party releases, funding for litigation trusts can be an important tool for a company as they plan for a chapter 11 filing. Particularly where the future debtor has claims against former management, a corporate affiliate, or other third-parties or holds insurance claims securing funding for a litigation trust can be helpful. Just as counsel may engage with other stakeholders in advance of filing to create a roadmap for how the case will proceed, debtor's counsel can use funding as a tool to facilitate a smooth and expeditious chapter 11 process.

For example, a company might find that the pre-filing negotiations with the majority of its creditors are straightforward, but that it holds significant claims against former management or other third parties which are interfering with a speedy resolution of

the case. In that case, the company might consider securing funding for a litigation trust at the outset, allowing the company to proceed through chapter 11 bankruptcy relatively quickly, and to avoid lengthy and expensive adversary proceeding. The litigation that would otherwise hold up confirmation and an exit from chapter 11 can be carved out and resolved separately. Particularly where the availability of third party releases is uncertain, setting up a funded trust structure at the outset can allow the debtor to exit bankruptcy quicker while still receiving the benefits of resolving certain fraudulent conveyance, tort or other litigation claims in the bankruptcy system.

Estate Finance to Pursue Claims

Similar to funding for litigation trusts, funders may provide capital to the estate to monetize claims. Here, the estate, not the trust, requires capital to pursue claims to enlarge the estate for the benefit of its creditors. This type of funding arrangement can be done on a single case basis, i.e., the funder provides funding to pursue only one cause of action, or on a portfolio basis, whereby the funder provides capital to pursue multiple causes of action. As with all funding structures, the capital is provided on a non-recourse basis. Funders like Woodsford provide capital at all stages of litigation, whether an adversary complaint has yet to be filed, or an



adversary proceeding is ongoing but now requires funding. Underwriting for this type of structure is similar to a typical commercial case funding structure and focuses on the legal and evidentiary merits of the case, realistic damages, and collectability, among other factors.

Funding allows the estate to pursue meritorious claims without concern that doing so will deplete estate resources and working capital in the process. A debtor has a fiduciary duty to act in the best interests of its creditors. In some cases, that interest may be best served by pursuing valuable and meritorious litigation claims that vest in the estate. Like with the litigation trust structure, the funder provides capital to cover costs and fees associated with the litigation, and the estate only owes the funder in the event of a win. Where an estate has valuable causes of action but faces cash flow constraints, funding may be a solution. Litigation funding provides a key to unlock the value of those causes of action and to distribute the value to the creditors.

DIP Funding

Funders may also provide debtor-in-possession or “DIP” financing to bankrupt estates. Some small to mid-market debtors with liquidity constraints may require post-petition financing in a smaller amount than traditional DIP lenders are willing to provide. Like all litigation funding structures, these are negotiated on a case-by-case basis. If you represent a small or middle market company interested in post-petition financing, please contact me directly (details below) to learn more.

Creditor-Side Funding Structures

Woodsford offers funding options for individual creditors, ad hoc groups of creditors, and official creditor groups to pursue their rights in bankruptcy. These structures are negotiated on a case-by-case basis and are tailored to the unique needs of the creditor(s) and the specific dynamics of the bankruptcy case.

Creditor Financing

Financing options are available to fund individual creditors or groups of creditors who require capital to assert their rights in a bankruptcy proceeding. Whether a creditor seeks to challenge a lien, remove priority without adding risk, or pursue claims against the debtor or other creditors, either on their own behalf or on behalf of the debtor in certain circumstances, funders can provide much needed resources.

Here, funding not only allows creditors the potential to pursue the claims to conclusion, but importantly, funding has the possibility to fundamentally change the leverage in the broader bankruptcy case. In circumstances where other parties – including other senior creditors – are aware that a junior creditor has capital to pursue claims to conclusion (or to substantially interfere with and delay the resolution of the chapter 11 case) those funded creditors are more likely to negotiate a better deal for themselves.

Moreover, funding provides certainty that counsel’s fees and other professional fees will be covered. Instead of having to “horse trade” certain positions in exchange for a budget (or increased budget) from the



estate, creditors with funding are able to vigorously pursue their rights and maximize recovery.

Woodsford offers funding solutions for creditors to pursue specific claims, whether that is a claim against the debtor, a third party, or an inter-creditor dispute, as well as broader structures that provide capital for creditors to hire professionals to work to enlarge the creditors' ultimate recovery. In all of these cases, the funding is non-recourse, with the funder receiving the deployed capital and a pre-negotiated portion of the litigation proceeds or

distributions in the event of success.

Claims Purchasing

A market also exists for selling and purchasing bankruptcy claims in their entirety. Some parties may also wish to sell their claims for an immediate discounted return rather than pursue their claims in the course of bankruptcy. This whitepaper focuses on the advantages of funding claimholders or the estate, but we are happy to discuss claim acquisition as well. Again, please contact me if you are interested in learning more about Woodsford's interest in purchasing claims.

Benefits of Litigation Finance in Bankruptcy & Restructuring

Litigation finance offers many benefits to parties who find themselves in bankruptcy court, either as a debtor or a creditor. In addition to the benefits to specific structures discussed above, litigation funding provides universal benefits: funding allows a party to hire the best lawyers and experts; receive the benefit of a second set of seasoned eyes; and can significantly improve dispute dynamics.

Improve Leverage in Bankruptcy Negotiations:

Working with a well-resourced funder can substantially change the dynamics of a dispute or settlement negotiation. With funding, parties have enough capital in hand to litigate an issue to conclusion with the best professionals and experts. And the knowledge that their adversary is fully resourced by an independent, dispassionate third-party that is very selective about the claims it invests in, sends a clear and powerful message to any defendant. This allows parties to credibly present the strength of their position and their willingness to vigorously pursue their rights in settlement or plan negotiations, in turn facilitating a larger recovery.

Receive the Benefit of a Set of Seasoned Eyes:

Litigation finance also functions as a no-cost means of evaluating a party's claims. Before committing to funding a case or litigation strategy on a non-recourse basis, litigation funders like Woodsford conduct comprehensive underwriting and diligence review. Woodsford's underwriters have experience advising clients on litigation strategy in bankruptcy court and in distressed situations and apply this



expertise in evaluating the evidentiary and legal strengths of the claim, the financial merits, and the anticipated outcome of various stages of the litigation. This

additional review and analysis can greatly improve the overall strategy for parties seeking to vindicate rights and maximize value in bankruptcy court.

Conclusion

Bankruptcy practitioners and other restructuring professionals ought to consider the role funding can play in advocating for and protecting their clients' interests. As discussed above, funding structures exist for all players in bankruptcy proceedings. Funding can unlock significant value associated with meritorious litigation for debtors and creditors, increase creditors' leverage in bankruptcy proceedings, and provide an additional mechanism for a debtor to discharge its fiduciary duty to maximize the estate. Moreover, litigation

trust funding can provide a solution to companies' facing significant pre-petition litigation who wish to avoid risk posed by non-consensual third party releases but who nonetheless wish to take advantage of certain benefits the U.S. bankruptcy system provides.

If you have any questions about bankruptcy litigation funding or have any claims that you would like us to finance, please contact me directly at dmazer@woodsford.com.



About the author

Deborah Mazer is an Investment Officer for Woodsford, based in New York. She is a U.S. lawyer and former litigator with a broad range of trial and appellate experience. Her expertise includes bankruptcy, complex commercial, mass tort, securities, tax controversy, and IP litigation.

Deborah has represented both creditors and debtors in several high-profile bankruptcy proceedings in New York and Delaware. She has also represented both plaintiffs and defendants in federal and state courts, the U.S. Court of Appeals for the Second and Third Circuits, and the United States Tax Court.

Before joining Woodsford, Deborah worked at Davis Polk & Wardwell in New York, and clerked for the Ontario Court of Appeals in Toronto, Canada.

Deborah received her J.D. from Yale Law School, where she was a co-director of the Palliative Care Medical Legal Partnership. She holds a B.A., with high distinction, from the University of Toronto.

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About Woodsford

Founded in 2010 and with a presence in New York, London, Brisbane, Philadelphia and Minneapolis, Woodsford is a leading ESG, access to justice and litigation finance business.

Whether it is helping consumers achieve collective redress, ensuring that investors and universities are properly compensated when Big Tech infringes intellectual property rights, or helping shareholders in collaborative, escalated engagement up to

and including litigation with listed companies, Woodsford is committed to ensuring the highest ESG standards while providing access to justice.

Working globally with many of the world's leading law firms, our legal experience, investment, business and technical expertise, in tandem with our significant financial muscle, makes us a powerful partner and a formidable adversary.