Episode 26 - How a strategic approach using litigation finance can help plaintiffs come out ahead against a bankrupt defendant

USA | June 15 2021

Click here to listen to the audio

Read the transcript below:

Amy Geise: Welcome to this episode of Beyond Hourly, hosted by Omni Bridgeway, one of the world's most experienced dispute funders and enforcement specialists. Our podcast focuses on commercial disputes around the globe and innovative ways to maximize value for clients in law firms. Episodes of this podcast can be found on our website, www.omnibridgeway.com, iTunes, Spotify, and other podcast networks. We welcome you to subscribe to the podcast and leave us reviews. My name is Amy Geise, and I'll be your hostess today.

On today's episode, we're going to talk to Deirdre Carey Brown of Forshey Prostok, about options for plaintiffs when a defendant files for bankruptcy—including how litigation funding might help plaintiffs maximize the value of their claims in the bankruptcy process. The general message of our discussion is that plaintiffs need not give up on potentially lucrative claims if the defendant files for bankruptcy. Yes, they'll face new challenges, but they may be able to turn the bankruptcy to their advantage. I asked Deirdre to join me today because of her substantial experience representing bankruptcy creditors and representing parties in bankruptcy litigation. Before we dive in, I'll briefly introduce myself and Deirdre to give our listeners some context.

I am an associate investment manager and legal counsel in Omni Bridgeway's Houston office, where I help steer our company's bankruptcy and insolvency initiative. I joined Omni about three years ago, and prior to that, I was in private practice as a bankruptcy attorney and a litigator at Porter Hedges, LLP. Deirdre Carey Brown is a partner in the Houston office of Forshey Prostok and practices in the areas of bankruptcy, business reorganizations and workouts, creditors' rights, construction, and commercial litigation in state and federal courts. Miss Brown has been included in the Texas Super Lawyers List, part of Thomson Reuters top-rated bankruptcy attorneys since 2016, and recognized in the 2021 Best Lawyers Business Law rankings. Miss Brown is board certified in business bankruptcy by the Texas Board of Legal Specialization and she sits on the TBLS Bankruptcy Law Exam Commission. Deirdre, thank you so much for joining us today.

Deirdre Carey Brown: Thank you for having me. I'm really excited about the prospect of litigation funding in the bankruptcy context. I think it's going to be a great educational device for a lot of the plaintiff lawyers out there.

Amy Geise: Great. Before we dive into the bankruptcy substance, I want to just ask you a few intro questions about your practice so listeners can get to know you a little better. What percentage of your practice involves a litigation component?

Deirdre Carey Brown: I would say 100%, ideally, daily litigation, 70% in bankruptcy. And when we say litigation today, we mean motion practice and actually contested hearings. Bankruptcy moves a lot faster than your state court proceedings or federal court proceedings. Every contested hearing is basically litigation.

Amy Geise: Yes, I actually felt the same way a bit when I was practicing, I did a lot more litigation as a bankruptcy lawyer than I did as a true commercial litigator.

Deirdre Carey Brown: More and more so in bankruptcy. Back in the day they used to say evidence rules did not apply in bankruptcy and that is not true anymore. It is just as intense as any other venue.

Amy Geise: When you're representing a client with litigation and bankruptcy, how does your role intersect with that of pre-existing litigation counsel?

Deirdre Carey Brown: There's going to be a variety of ways that we would interact with the pre-litigation counsel. One is if we're debtors counsel, we may retain that counsel as special counsel to continue to pursue the litigation, whether in or outside of bankruptcy. If the special counsel or the pre-bankruptcy counsel is kind of interested in having us handle the main litigation, we can do that as well. A lot of bankruptcy attorneys will have a separate team than does the litigation. However, in our firm, we handle the litigation as well as the bankruptcy side so we're kind of a full service firm that way, but we work with a lot of special counsel as well, because there's just unique practice areas where it helps to have the special counsel as well.

Amy Geise: Absolutely. I feel like many have probably observed that trend of bankruptcy lawyers in particular veering towards hyper-specialty, where you have the litigation team and the more corporate finance-facing teams. It's really valuable to have teams like yours that can function in both spaces and have one lawyer at the podium for the whole discussion.

Deirdre Carey Brown: One lawyer, one tech person—we do it all.

Amy Geise: We'll start at what I call our bankruptcy one-on-one discussion where it kind of all begins for a plaintiff, which is 11 U.S.C. § 362. This is the provision that enacts what bankruptcy lawyers call the automatic stay and the filing of a bankruptcy case operates as this automatic stay, or pause, on the commencement or the continuation of most legal actions against a debtor in possession. That would include litigation like this that was commenced before the bankruptcy. Plaintiffs now finding themselves creditors of the debtor's bankruptcy estate need to carefully observe the automatic stay —this pause in their lawsuit—because there could be very serious consequences for violating it and continuing their litigation.

Deirdre, what are a plaintiff's options once their litigation has been stayed?

Deirdre Carey Brown: Right. Presuming that the plaintiff is a creditor, you can seek to lift the stay by filing a motion in the bankruptcy court to lift the stay, you can just let the case sit for a while and do nothing and see how the bankruptcy plays out, or you can try to figure out what the recoveries are going to be in the bankruptcy before dedicating a lot of resources to lifting the stay. I say that because a motion to lift the stay can almost be a trial on the case itself. You need to be prepared in all respects if you're going to file a motion to lift stay, especially here in the Southern District of Texas. Our Houston judges are very sophisticated and they're going to make sure that lifting the stay makes sense for the estate

at that time, because that breathing room that the automatic stay provides to a large debtor in particular is going to be valued pretty highly by the court, especially early in a case. You also want to look at your overall strategy and figure out the best way to navigate through the process.

You may have more settlement leverage with the debtor if you hold off trying to lift this debt, because they may have more incentive to resolve your claims and not give a heads up to other creditors who could follow in your path behind you. You can also remove the litigation to the bankruptcy court—maybe the state court wasn't your best venue—and you want to remove the case. You could do that. And the flip side of that is true as well. The defendants, or co-defendants of the debtor, could decide that removal makes sense. Typically, on removal, there is a procedural mechanism where you would remove to the district court and then it goes to the bankruptcy court, but we know most districts have automatic referrals so you're really just removing to the bankruptcy court. It could be that you just get the case resolved through the bankruptcy and that may in most cases be your best option.

You may mediate in the bankruptcy court. Also, if there are co-defendants—let's say the directors and officers in the company are all in a suit together—you could attempt to sever out in the state court—file a motion to sever out the non-debtor parties. You have to be careful though, because you need to make sure that you're only pursuing claims that are direct claims that your client owns and not derivative claims of the company—and that can get pretty cloudy at times. You may seek a comfort order with the bankruptcy court to lift the stay as to those issues as well. I always recommend reaching out to the debtor ahead of time and trying to get some type of consensual process for lifting the stay versus just popping off with a motion to lift stay in a very aggressive, contentious matter. Bankruptcy highly favors settlement, and it's usually the law of diminishing returns so you're trying to maximize recovery and limit costs.

Amy Geise: That was incredibly comprehensive and leaves us a lot to unpack. I think where I want to start—because it sounds like there are a lot of options and a lot of different factors to consider for a plaintiff in deciding which of those options yields the best path forward—is , you mentioned that the motion to lift stay process shouldn't be underestimated. It can be a very intense, evidentiary, substantive hearing and my question from that is, if a plaintiff goes down that road and for one reason or another—maybe they weren't adequately prepared, but maybe the judge just, like you said, is inclined to give the debtor the breathing room than the stay provides and the judge denies the motion to lift stay—what happens to the litigation and the plaintiff's claim once the court refuses to allow it to proceed?

Deirdre Carey Brown: Usually, if a motion to lift stay is denied, it's denied without prejudice—especially if it's premature in the case. There's nothing that's going to hamstring you from filing a motion in the future. But strategically, again, if you filed that prematurely or you were unprepared for a hearing that means the story that was told is not the best story for your client. That's why you really have to be cautious in how you proceed and really think about the whole game moving forward. You can still proceed with litigation. You can remove the litigation to the bankruptcy court. If the court doesn't want to proceed with the motion of stay, that doesn't mean that the court is going to go forward with the adversary proceeding, but at least you have it teed up in the bankruptcy court so that it can be live litigation.

Alternatively, what I would suggest is while you are stayed, you actually evaluate the recovery scenario for your client so you know what the best settlement potentially is. That can be done with what's called the Rule 2004 examinations to get general information on the background of the debtor, and you can be active in monitoring the bankruptcy. And a Rule 2004 examination is much broader discovery than you would've been allowed in your original litigation and allows you to delve into the financials of the debtor so that you can identify your collectability of the judgment.

Amy Geise: That's actually another point that I wanted to raise to our listeners—and I think ties to one of your earlier comments that, in a lot of ways that bankruptcy forum can actually be quite attractive for plaintiffs as a venue for resolution even though it may seem counterintuitive—as you just said, 2004 discovery grants much more liberal insight and discovery permissibility into the debtors assets. Likewise, the debtors are often required to file monthly operating

reports that demonstrate to plaintiffs how their business is faring—they're required to file schedules of their assets and liabilities at the beginning of the case—so plaintiffs have a tremendous amount of insight as to what they're actually going to get out of the judgment if they're able to resolve their claims to judgment. Often times collection is a good percentage of the battle as a plaintiff. You may very well make the determination that it's not worth the expense to pour the time and money into litigation if there just isn't the cash to pay a judgment anyway.

You also mentioned a few other reasons that it may be preferable to resolve a dispute within the confines of a bankruptcy case. I just want to touch on that in a bit more detail. In your view, what are some of the key advantages to resolution within the bankruptcy forum?

Deirdre Carey Brown: There are a number of key advantages. One, it gives you the opportunity to have creative settlement options, which you would not have been able to do outside of bankruptcy—at least not do without subject to challenge from other creditors. Because the settlement in the bankruptcy context will be with notice to all creditors and they will all have an opportunity to object, and if the court approves a final order approving your settlement, then you know you have certainty—so that would be another key factor, the certainty that a settlement in bankruptcy can give you. It also addresses the time value of money. If you can get a quick resolution in the bankruptcy, because there's now an incentive for your defendant to actually act and get the case resolved—and sometimes your case may be a driving reason that they filed bankruptcy to begin with—you'll have that certainty, you'll decrease the costs.

There'll be less litigation costs, less attorney costs—not just for you, but also for the debtor, which frees up money to pay your judgment. You can put pressure on the other parties in the case, especially co-defendants. It can be a way to try to tee everybody up at the same time and get a global resolution because if they had competing claims or they were third party debtors, they'll all be part of the bankruptcy and those will be all the claims that are subject to resolution in the bankruptcy.

Finally, and I can't stress this one the most, mediation. In the Southern District of Texas in particular, there is a very active effort at mediation and that has been used to resolve large disputes in many cases. What I should note here in the Southern District, also, the judges themselves have been very open to mediation. If you're in front of one judge, one of the other four judges may be willing to mediate the case. And it has proved highly effective simply because parties seem to respond better to a bankruptcy judge on bankruptcy issues than just an attorney who's mediating, so there are a lot of advantages.

Amy Geise: Having an effective mediator is crucial—obviously, a sitting judge, a mediator that both parties are going to respect. I feel like it's become increasingly difficult to reach an effective resolution at mediation and that kind of authority and overt support by the judge himself—that this is a dispute that really should get resolved—is very helpful in motivating the parties to get to a result.

Say there's a settlement reached, and whether it's through a mediation with another judge or outside of the mediation context, there are certain rules that parties must comply with in bankruptcy settlements. Those are outlined in 9019 of the Federal Rules of Bankruptcy Procedure. Deirdre, what does Rule 9019 require of the parties?

Deirdre Carey Brown: Typically, what you're going to see is the debtor will file a motion to approve the compromise under Rule 9019. The compromise—it's going to have to be fair and equitable, it's going to have to show a benefit to the estate. Settlements are favored in bankruptcy and so the motion for the most part is boilerplate. It would discuss the complexity of the case, the expense of the case, the duration, the collectability, and the reasonableness. Those are all factors that come out of cases that have decided 9019 motions.

The settlement will have to follow the absolute priority rule. The absolute priority rule in bankruptcy simply stated is that the payments have to be in priority that they would have received under the bankruptcy code. You can't jump ahead of a secured creditor with a settlement—you'll have to file the priority of the bankruptcy scene. Typically, the secured creditors should have been consulted under the *Foster Mortgage* case about that settlement ahead of time.

Amy Geise: Once the motion's on file, what does the approval process look like?

Deirdre Carey Brown: That's on 21 day notice. If nobody objects, then the court will just enter an order usually. Many judges will set it for hearing regardless and if a hearing is set it'll pretty much be a pro forma approval, unless the court itself has questions. It's going to be the debtor or the trustee proving up that motion, not the creditor who's settling, but the creditor can be a part of the process. Anybody can object to the settlement though.

I guess we can talk about that, if there's an objection and that becomes the contested hearing I was talking about earlier, where it can be kind of a mini-trial on the issue. But for the most part, if the settlement was reasonably entered into and had business judgment—the debtor used its best business judgment—settlements are approved.

Amy Geise: Well—and I imagine there's a certain appeal to having a settlement expressly approved and blessed by a bankruptcy court, even though it does involve this extra procedural hurdle. I know that parties to litigation often struggle with settlement defaults—I wonder, does the judge's blessing give the judge any post-settlement ability to enforce the terms if one party subsequently defaults?

Deirdre Carey Brown: Typically—especially the debtor, will have jurisdiction language in the order approving the settlement—allowing continued jurisdiction by the bankruptcy court. You can always go back to the bankruptcy court to review its own orders. It could even be after the bankruptcy case is closed, frankly. You can do a motion to reopen the case and say they've defaulted under the settlement, especially since you've got a judge who's very familiar with the issues. There's all kinds of opportunities with bankruptcy. Also, we said file a motion to follow the 9019, but a settlement can also be wrapped into a plan where there's not a separate motion that's filed and it all becomes part and parcel of the planned process in the chapter 11 because you can do settlements in chapter 7 or chapter 11, or even chapter 13.

But in the chapter 11 process, you can do that settlement as part of the plan. Also, in some of the big complex cases, they'll have an omnibus motion on file that gives the debtor settlement authority under certain procedures. So, a settlement procedures order has been entered and there may be ways to do a settlement without court approval. Typically, if I'm representing somebody settling I want at least a stipulation and order that's signed off by the court so that you have that added hammer, as you were kind of describing, to go back to the bankruptcy court to enforce it.

Amy Geise: I think you've provided a very natural segue into another topic that I want to discuss with our listeners, and that is actions that a plaintiff should monitor outside of their own litigation when the defendant has filed for bankruptcy. There's going to be a lot going on in this bankruptcy case, especially if the defendant is a big company and unfortunately the plaintiff can't stay micro-focused on their case because there's a number of other ways that the overall bankruptcy might impact their rights. And kind of a basic one that plaintiffs should keep in mind is that they usually choose to file proof of claim to reserve their rights against the debtor. Although the proof of claim itself does not ensure payment in any sum certain that will all depend on the economics of the case and the treatment of their litigation claim in particular.

Plaintiff should be aware that filing a proof of claim could be deemed consenting to the jurisdiction of the bankruptcy court, but that's certainly kind of a fundamental action that plaintiffs should keep in mind in the overall course of the debtor's case. I don't know, Deirdre, if you have any other specific thoughts on the nuances of filing a claim, but I welcome your thoughts as well.

Deirdre Carey Brown: While we were talking about monitoring the bankruptcy, I wanted to touch on a couple of those issues, as well as the proof of filing to kind of segue together. One, if your client is listed on the schedule and the box for disputed, contingent, unresolved is now in check, you don't have to file a proof of claim in the chapter 11 context. You really want to be careful strategically if you are listed on the schedules—as in are marked as disputed—and not file the proof of claim because the proof of claim filing, as you were mentioning, has a jurisdictional element where you're accepting the jurisdiction of the bankruptcy court—so you're going to want to monitor that deadline. That deadline is really a good reason to get your case resolved ahead of time so that you don't have to worry about the deadline and/or getting an extension of time from the debtor filing your proof of claim if you think there is a potential for resolution.

You also have to keep in mind the removal deadline, which is going to be 90 days from the date that the bankruptcy is filed. When a bankruptcy is filed, there's usually a 341 meeting where you can go to that meeting and get free discovery. That free discovery may also impact when and how you want to file the proof of claim. In particular, and I can't stress this enough, if your client is extraterritorial—so let's say your client's in England or Taiwan or China—and you filed proof of claim here in the U.S., you have just invited them in any litigation related to the debtor. It may not be by the debtor, but any litigation relating to the debtor could potentially be pursued here in the U.S. simply because you filed a proof of claim. If that client was only for a couple thousand dollars, but the claims against your client are in the millions, that would have been a huge strategic blunder. So, you really have to be careful with filing a proof of claim.

Amy Geise: I feel like that becomes even more of an issue for small trade creditor type claims. In the Southern District of Texas, of course, we see it with big oil and gas companies and they have trade creditors all over the world that they may also have some pretty big litigation with. And certainly, you don't want to accidentally invite all of your global arbitration and litigation disputes into the Southern District of Texas bankruptcy court without knowing fully what you're doing.

What about the plan process? You mentioned earlier that the plan can be a vehicle to effectuate litigation settlements. What else should plaintiffs know about the plan process and what might they want to keep track of during the case?

Deirdre Carey Brown: The plan is required to be filed by the debtor within a certain period of time, otherwise, they lose their exclusivity and they may extend that exclusivity. If it is a very contentious case, you may want to monitor the deadline for filing the plan. You can always file a competing plan. That's going to be more in your small cases. In your larger complex cases, there's going to be a disclosure statement that gets filed in the plan. The disclosure statement has to be approved. Typically, unless the disclosure statement has false information or is just completely inadequate, there's not a need to object to the disclosure statement itself. The plan itself will then come up for a confirmation hearing—any discovery you need, you need to do prior to that confirmation hearing. Don't go in whining and saying, we didn't have time to do discovery, or we don't know what these facts are.

That's what the discovery process is for. It may be you have 20 days between the time that you learn of the confirmation hearing, but you should have been preparing all along because as soon as the debtor files bankruptcy, that's what you're preparing for in a chapter 11 context—the confirmation. You may need to really scrutinize the plan to make sure there aren't negative impacts to your client even if you have specific protective language that the debtor has agreed to. For example, some of the terms that you need to look at are planned injunctions, which may be anti-suit injunctions going forward after the bankruptcy, the discharges, discharge injunctions, language that dismisses your case and the reservation of jurisdiction in the bankruptcy court. You're going to want to make sure to look at the types of provisions and do the best you can to carve out protection for your client.

You may also want to see if everybody's being treated fairly. Are certain unsecured creditors jumping ahead of your unsecured client? One thing I need to jump back on when we're talking about future claims is for class claims. If you are representing a class, you will need to file a motion to approve the filing of a class claim. And that is a whole separate process which we could do a whole separate webinar on. But class claims are different—you don't have an automatic right to file a class claim, so let's make sure that's clear.

Amy Geise: I think that if there is one thing this discussion has underscored it's that, if I'm a plaintiff, I need to hire you when my defendant files for bankruptcy. I mean, really there is just, I think, such a wealth of knowledge that you have shared based on your really deep experience in the many, many ways that rights might be impacted by the bankruptcy case, the strategic considerations that a plaintiff needs to keep in mind and all the ins-and-outs of a complex bankruptcy process that you really have to appreciate in order to make those strategic decisions in an informed fashion. I think it seems quite clear that plaintiffs whose disputes end up in bankruptcy are really well-advised to supplement their litigation counsel with an experienced bankruptcy lawyer.

Now, unfortunately this comes with an added price tag, and that might seem particularly unpalatable in the face of a defendant who's filed for bankruptcy. I'm wondering if that's a concern or an issue that you've experienced, Deirdre. Do you think concerns regarding fees prevents plaintiffs from hiring the right professionals when they find themselves embroiled in a bankruptcy case?

Deirdre Carey Brown: You asked that question and I wonder if it prevents them from hiring the right credentials, or they're just not aware of the ways to come up with financing for the fees. I do think, as I was mentioning at the beginning of the podcast, that it is imperative to have bankruptcy counsel. Even if you have the best litigation counsel out there, if they don't have people in their firm that have bankruptcy backgrounds, you are going to be at a disadvantage in hiring the right bankruptcy counsel. That does not mean bankruptcy counsel needs to take over litigation though, but they do need to advise through the process so that you don't misstep, because the most minor misstep could really impact the court's impression of your claim going forward and just sets the story off where the debtor is going to have the upper hand. I think it's more of an issue if people aren't as familiar with litigation funding in the bankruptcy context as they are outside of bankruptcy.

Amy Geise: I've definitely seen that and it's a conversation that's becoming, I think, more readily available, more familiar. I think particularly for plaintiffs who find their case pulled into a bankruptcy because of a defendant that files often have this reaction that, “my case is worth nothing now”. The last thing that comes to mind is, “maybe a litigation funder might be a great source to help me make the most out of the position we're in.” It's perfectly possible that the existing litigation counsel is on a contingent fee, so they wouldn't need litigation financing in the first instance. But the fact that your case is in a bankruptcy does not mean that there won't still be a substantial recovery that could support a litigation funding deal. And in fact, litigation funding could be the help you need—providing the non-recourse capital to pay attorney's fees of your bankruptcy lawyer or possibly even your pre-existing litigation counsel, depending on the fee structure that you already have in place.

The non-recourse nature means that if the plaintiff doesn't recover—and that's not just the amount of the judgment, it's actual recoveries realized out of the bankruptcy estate—then the plaintiff won't owe the funder anything. The funder's recoveries are strictly limited to litigation recoveries. Now, obviously it will all depend on the budget and the overall case economics—whether litigation funding is going to be practicable under the circumstances—the biggest question mark here is going to be the realistic damages assessment. Obviously there's a whole other component to that assessment once you're in a bankruptcy, it's not just the nice damages file that your expert has supported, but it's going to involve a recovery analysis from the estate and projected payouts to creditors.

You should really make sure, particularly in this situation, that you're contacting a reputable funder that is going to have—as one of its priorities-to have a case overall economics that support the investment because otherwise you could end up in a situation where the funder puts in too much and then at the end of the day, the funder takes a hundred percent of the recoveries that are realized on the backend. That is never how we want to structure things at Omni Bridgeway. Not only because we think it's fair that the plaintiff end up with some of the recovery at the end of the day, but also because it fundamentally aligns the economic interests of everyone in reaching a mutually beneficial result, whether that's a settlement for the right dollar amount at the right point in time, or whether it's fighting the case all the way through a contested hearing, or removing it and having a full-blown trial.

There are definitely funders out there that don't make that a priority—that there's enough upside for everyone to get a cut at the end—but it's something that is even more important when you're dealing with a bankruptcy.

Deirdre Carey Brown: Can I just tailgate on that—I think it's really important to have a reputable litigation funder because they have the processes and procedures in place, and they know the ethical rules and pitfalls, that you're not going to have with some of these solo lenders out there who are looking for a quick percentage or a quick ROI on some type of litigation funding. There are a lot of traps, especially in the bankruptcy context and firms like Omni Bridgeway and others—they know what those are. They're not going to violate those rules because this is their bread and butter. This is what they're doing day in, day out.

Amy Geise: Absolutely. And as the market has continued to grow, the litigation funding market, that's becoming an increasing concern and issue that parties who are interested in exploring it need to be aware of. Because there are ethical pitfalls that if your funder isn't really on the up-and-up, it could ultimately inure to the detriment of your case. You don't want to jeopardize your privilege. You don't want to jeopardize your control over the case as the plaintiff, and as an attorney, you don't want to jeopardize your fiduciary duty to your client.

A couple of recap questions. This has been, I think, just such a robust discussion and Deirdre, I really appreciate all of your time and insight. What advice would you give to a plaintiff whose defendant has filed for bankruptcy? If you could just give them a five sentence takeaway here.

Deirdre Carey Brown: One, look at the big picture. Two, review the bankruptcy filings. Three, develop a strategy—plan A, plan B, plan C—and four, know what your bottom line recovery is and what you're willing to do. You can fight on principle, but generally we fight and litigate to get a recovery. You may not want to settle before bankruptcy and now that the bankruptcy is filed, there may be a bigger incentive and you might actually get a better return with settlement than if you keep fighting.

Amy Geise: Absolutely. I think that is very sage advice. All right. Well, again, Deirdre thank you so much for being our guest today and for sharing your knowledge with our listeners. You can access a transcript of this podcast on our website at www.omnibridgeway.com. I invite you to follow up with me Amy Geise, at ageise@omnibridgeway.com for any feedback, ideas, or insights that you have on topics we should cover on the podcast in the future. Thank you so much for listening and goodbye.