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Portfolio Litigation Funding

By

[Joel E. Cohen](#), Stout

[Amy T. Geise](#), Omni Bridgeway, and

[Ken Epstein](#), Omni Bridgeway

Federal equity receivers and the agencies that employ them often encounter a similar problem: the estate has no money to pursue litigation against the individuals and entities that have defrauded or manipulated consumers or investors. To solve the problem, receivers frequently turn to contingency fee counsel to litigate the claims and attempt to recover money for the estate in exchange for a percent of the recoveries. But counsel's percent of the recovered funds – usually between 30 and 50% – may deprive the receivership estate of a significant portion of the award.

This is where litigation funding is a useful tool. Depending on case economics, litigation funding can result in the receivership estate keeping a significantly greater portion of the recovery than it would under a contingent fee agreement.

Litigation funding also offers receivers the option to develop a hybrid approach to financing the estate. For instance, receivers may use litigation funding to engage counsel on a partial contingent fee – *i.e.*, a reduced hourly rate plus a reduced contingent fee. Receivers also may finance some estate claims through a litigation funder but not others. In addition, litigation funding may be used to pay attorney fees, litigation costs, and under the right circumstances, administrative expenses of the receivership. This flexibility enables receivers to coordinate with a litigation funder and counsel to devise a strategy that will maximize potential recoveries for the estate.

How Litigation Funding Benefits Receivers

Litigation funding can be deployed for a single case or a portfolio of cases. With portfolios, litigation funders typically receive a return based on a multiple of their deployed capital, rather than a percentage of the litigation proceeds. This is an important distinction. If the litigation proceeds are expected to be substantial, a funding arrangement can result in the receivership estate keeping significantly more money than it would under a contingent percentage fee arrangement.

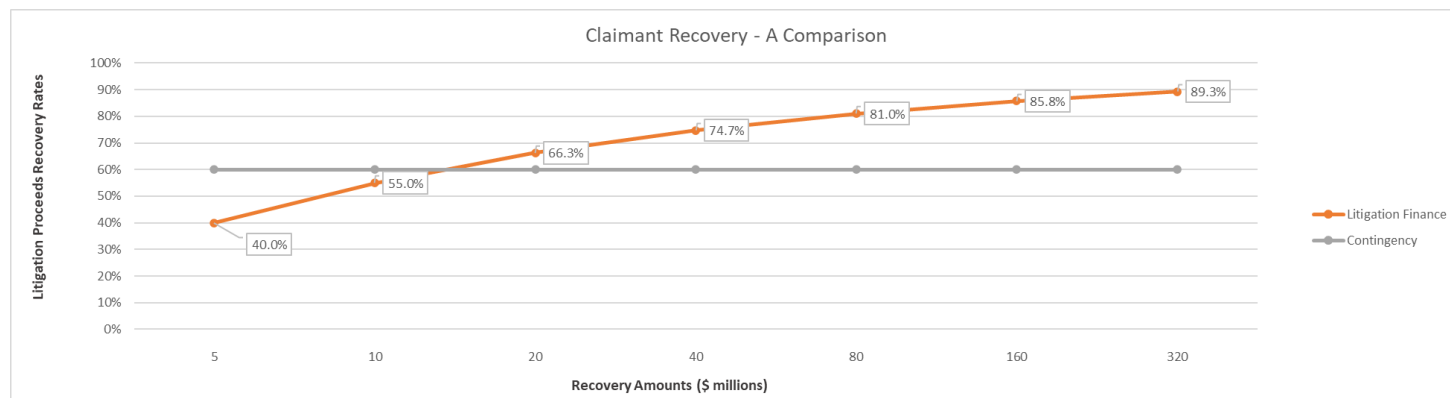
Imagine the following scenario: A receivership estate has five legal claims worth a total of \$100 million. Litigating all five claims will cost millions of dollars in attorney's fees and costs. In the following scenario we assumed \$5.7 million in legal fees and costs. But the estate only has \$2.5 million in assets available and \$2.5 million in administrative costs, leaving no money to spend on litigation. The estate can either enter into a contingent fee arrangement, in which it will pay counsel 40% of total recoveries, or a portfolio funding arrangement with a litigation funder.

In the portfolio context, the litigation funder’s return will likely be a multiple of deployed funds rather than a percentage of the ultimate recovery. A fairly typical return in 2-4 years is three times (3x) the deployed capital, which is what we assume in the below illustration. What makes more sense: paying a multiple of litigation costs or a percentage of the proceeds recovered? The answer depends on the circumstances, but particularly when the estate has substantial damages, the former option often allows it to keep more of the upside:

	Contingent Fee Counsel	Portfolio Funding
Litigation Recoveries	\$100,000,000	\$100,000,000
Payment upon Successful Resolution	\$40,000,000 (40% contingency fee)	\$17,100,000 (3x deployed capital)
Amount Left for Distribution to Claimants	\$60,000,000	\$82,900,000

In the example above, portfolio funding results in a better return for the receivership estate by preserving an additional \$22.9 million that otherwise would have gone to pay counsel’s contingency fee.

There is, however, a point at which a straight contingent fee arrangement (percentage-based cost) is less expensive than portfolio funding (multiple-based cost). The inflection point will vary depending on several factors. The below graph demonstrates how the percentage of distributions to claimants change as recoveries increase from \$5 million to \$320 million. To make the assumptions more realistic, we assume that the total amount of legal fees and expenses (i.e., the costs to pursue the cases) increase as the anticipated recovery amounts increase. We assume that legal fees will be a minimum of \$1.0 million and that when the anticipated recovery amount doubles, the total fees increase by a factor of 1.5x. As shown below, the inflection point under these assumptions is approximately \$15 million.



If the expected litigation fees are relatively large in comparison with the likely proceeds from the litigation, a percentage-based contingency fee arrangement will likely be more economical. When damages across multiple claims are sufficiently great, however, a multiple-based arrangement could be better for the estate.

Bundling multiple claims together as collateral may enable the estate to access capital more cheaply. Different underlying claims, varying legal theories, and unrelated defendants reduce the risk of a zero recovery and are therefore more attractive to a funder. Diversity among portfolio cases thus typically allows a funder to provide more favorable terms.

Added Flexibility and Added Benefits

In addition to the potential economic advantages, litigation funding may be preferable to a straight contingent fee arrangement because it enables receivers to engage a wider variety of legal teams, including those that prefer (or in some circumstances, can *only* work on) an hourly fee structure. This flexibility is particularly useful when a receiver

wishes to retain the company's preexisting counsel but would otherwise be unable to do so due to budgetary constraints.

Portfolio funding also allows receivers to adopt a hybrid approach, using both a litigation funder and contingent fee counsel. Indeed, litigation funders usually prefer to structure deals with counsel engaged on a hybrid fee – *i.e.*, a reduced contingent fee plus a reduced hourly rate. Moreover, receivers may choose to finance some estate claims through a litigation funder but not others, although at least three cases are required in a portfolio funding arrangement.

In some circumstances, a funder may agree that deployed funds can be used to pay administrative costs of the receivership or to pay expert and financial advisory fees. This unique aspect of litigation funding thus enables a receiver to simultaneously pursue potentially meritorious and lucrative litigation without draining resources of the receivership estate. This type of hybrid approach also provides tangible benefits to the contingency law firm by reducing expenses, easing its cash flow problems, etc.

Litigation funding may also be an indispensable resource for receivers undertaking preliminary investigations into the viability of claims. Such early-stage undertakings are notoriously challenging to fund, often creating an obstacle for receivers charged with recovering assets for defrauded investors or consumers. Litigation funders may be able to offer a solution by providing nonrecourse seed funding to cover fees and expenses associated with a preliminary case investigation. Although certainly not appropriate for all estates in receivership, "seed funding" of this type can enable receivers to support their convictions regarding the strength of potential claims, and consequently, to present a more compelling statement of the case to the requisite authorities, including federal agencies, and professionals.

Conclusion

The decision about whether to pursue a cause of action, and how vigorously to pursue it, should turn on the merits of the case and not the parties' financial resources. Receivers should consider portfolio litigation funding as a source of capital, as it may offer the most cost-effective approach to pursuing meritorious claims and maximizing recoveries for the estate. The specifics of the claims will determine the best path for each receiver, but it is important for receivers and federal agencies to understand the options available.

The views expressed in this article are those of the authors alone.

About the Authors:

Joel Cohen is a Managing Director in the Disputes, Compliance, & Investigations group of Stout's New York Office. Joel has over 19 years of experience in the dispute, forensic, and insolvency practice areas, most specifically focused in the financial services and asset management industries. His experience encompasses a number of significant cross-border insolvency and litigation matters, where he has served as financial advisor and consulting expert to fiduciaries, Receivers, offshore liquidators, bankruptcy, litigation trustees and their counsel.

Amy Geise is an Associate Investment Manager and Legal Counsel in Omni Bridgeway's Houston office, where she helps steer Omni Bridgeway's bankruptcy and insolvency initiative. Amy frequently works with debtors, creditors, and other stakeholders to optimize the value of their claims. Amy is also experienced in helping commercial litigants obtain non-recourse funding for their disputes outside of bankruptcy. Prior to joining Omni, Amy practiced as a bankruptcy attorney and a litigator at Porter Hedges LLP.

Ken Epstein is an investment manager and legal counsel at Omni Bridgeway, responsible for leading the company's investments in bankruptcy and insolvency-related matters. He began his career as a lawyer in the financial restructuring group of Cadwalader, Wickersham & Taft. Prior to joining Omni Bridgeway, he was managing director in the restructuring and remediation group at MBIA, a financial services company.