



Burford

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Q&A: An interview with Lee Buchwald and Nicholas Kajon

In September 2016, MagCorp. bankruptcy trustee Lee Buchwald and attorney Nicholas Kajon of Stevens & Lee arranged the unprecedented sale at public auction of an interest in the right to receive litigation recoveries from a \$213 million judgment on appeal. The \$26.2 million sale to Gerchen Keller Capital (later acquired by Burford) enabled the estate to liquidate a portion of a contingent asset, hedge against appellate risk and guarantee a minimum recovery to creditors. On March 8, 2017, the US Court of Appeals for the Second Circuit issued a summary affirmance of judgment, a win for MagCorp.

How did the idea of using litigation finance in this unprecedented way come about?

Buchwald: I only had about \$670,000 in the bank and had been litigating with a billionaire for 13 years. While I was confident I would ultimately win the appeal and collect on my \$213 million judgment (as well as my cross-appeal for additional interest), all litigation is inherently speculative. Therefore, I sought funding to hedge my downside exposure, build a war chest in the unlikely event the defendants win their appeal for a new trial, and guarantee that no matter what happens in the litigation there will be money available to distribute to MagCorp's long-suffering creditors.

I looked at the situation primarily from a business person's perspective. I came up with the idea of, in effect, selling an option to acquire an asset (the \$213 million judgment) that may or may not have future value, akin to selling a call option on a stock. If the market value of the stock was below the option's strike price on its expiration date, I'd pocket the proceeds from the sale of the option which I would keep regardless of the outcome. If the stock was above the strike price, I would forego the difference between strike price and the market price. I knew that Nick had worked with litigation funders in the past, and asked him if this "option" concept was viable, wherein a litigation funder would be the option buyer. To my shock and surprise, he actually thought it could work!

Kajon: While Lee's "option" idea was not the usual litigation finance situation, I believed litigation funders might be interested in monetizing a fully-bonded judgment subject to appeal. However, I also warned

Lee that he was unlikely to be satisfied with the pricing. We decided there was nothing to lose by testing the waters, and we were both pleasantly surprised to receive expressions of interest from GKC and other funders in a range that we believed was reasonable and likely to be approved by the bankruptcy court.

What concerns from stakeholders had to be overcome for this to move forward?

Kajon: A group of note holders objected to the transaction on the grounds that it was unnecessary and too expensive. When challenged in bankruptcy court, we introduced evidence demonstrating the business justification for the transaction and the reasonableness of the consideration to overcome the note holders' objection.

The defendants objected by submitting an offer they said was better than the deal with GKC. We anticipated that the defendants would recognize that funding from GKC would put Lee in a much stronger position going forward, and so we were well-prepared for the challenge. We demonstrated that the so-called offer submitted by the defendants was illusory. Moreover, while the defendants' offer was nominally higher than the offer submitted by GKC, its terms were far less advantageous for the estate even if all its inherent flaws could be overcome.

Buchwald: The court accorded significant deference to my business judgment and the fact that I had been dealing with these issues for thirteen years; the note holders had only recently organized and thus could not be in a position to second-guess my business judgment.

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How would you distill the value that legal finance offers to stakeholders in situations like this?

Buchwald: The liquidity that the litigation finance industry can provide is a game-changer. I do a lot of work as a bankruptcy trustee, and fully understand the superior results that can be achieved by being well-funded. Furthermore, litigation funders are impartial and profit-motivated. I may believe that a case of mine is meritorious. However, if potential funders are not interested I may save the stakeholders a lot of time and money by choosing not to litigate.

Court approval was required and involved multiple hearings and strong opposition from the defendant. What lessons would you share from that experience?

Kajon: Clearly, you first need to meticulously analyze all the issues and anticipate any potential objections. Then, you should file a strong set of motion papers explaining the business justification for the transaction and why it is in the best interest of the debtor's estate. You need to structure the transaction carefully to maximize value and avoid any pitfalls: For instance, we structured the transaction as a sale, rather than a financing, so that we could run an auction process. Furthermore, you cannot sell avoidance actions such as fraudulent transfers and preference claims because they must be prosecuted for the benefit of the debtor's estate. However, you can sell an interest in the recoveries, as we did. We also recognized that our window of opportunity was between the time our opening brief was filed and the earliest date that oral argument might be held, so we set up a process that could be run and completed between those two goalposts.

"Litigation finance" seems too narrow a descriptor for the creative problem-solving involved in securing outside funding for such an illiquid asset. Where do you see opportunity for innovation?

Kajon: I agree. Obviously, litigation finance can be used in the traditional manner to fund a particular lawsuit at inception against a particular set of defendants. However, it can also be used to monetize any claims at any stage through all sorts of creative techniques. The only limits are your imagination, and clever lawyers can devise myriad avenues for unlocking this tremendous opportunity.

What advice do you have for others seeking outside financing for litigation assets or other legal receivables in bankruptcy scenarios?

Buchwald: Be creative. Think outside the box. Just because no one has done it before doesn't mean you shouldn't try.

Kajon: And once you have come up with a creative idea, package it to appeal to litigation funders. We developed a "teaser" to ascertain interest in a potential transaction, but we waited until our opening brief had been filed, which we used as a powerful marketing tool.

Do you foresee increased use of legal finance by bankruptcy practitioners?

Kajon: Bankruptcy is ideally suited to capitalize on the benefits that can be provided by litigation finance. In bankruptcy it is rare to have sufficient funds to prosecute litigation claims against deep-pocketed defendants. Moreover, even if funds are available, creditors who are already facing a significant loss are loathe to "throw good money after bad," especially where recoveries are speculative and years away. Litigation finance solves that problem by letting creditors receive today whatever funds are available in the estate, and then at no direct cost to them have litigation claims prosecuted for their benefit to augment their recovery.

The business of law is notoriously slow to innovate. Do you feel there remains some truth to this cliché, and if so, where would you most like to see innovation?

Buchwald: I think that law, by its nature, is steeped in the concept of precedence. I read lots of briefs that cite cases going back as far as the Magna Carta! Kidding aside, I think that lawyers are trained to look back instead of forward, which stifles innovation.

Kajon: Over the course of my career, I have dealt far too many times with attorneys who take a cookie-cutter approach to the practice of law, i.e., they want to run this case just like a similar case they had in the past. However, even similar cases have their differences, and all clients have different needs, expectations, tolerances for risk, time horizons and budgets. You can certainly learn from your past experiences, but you need to apply your knowledge and experience to the matter at hand and not confine yourself to an approach that is set in stone. It is always refreshing when I work on matters with attorneys who have a similar perspective, and who are not afraid to try something new.

I believe that the burgeoning field of litigation finance offers a tremendous opportunity for lawyers to use innovation to achieve superior results for their clients, especially in bankruptcy cases where resources are scarce. Many people also fail to realize that litigation finance can be used on the defense side, where the funder will underwrite a fulsome defense budget to achieve enhanced results, and then receive a return tied to the savings the defendant achieves.



Lee Buchwald is President of Buchwald Capital Advisors LLC, an investment banking firm specializing in financial restructuring, fiduciary and advisory services. He has managed over 120 transactions, serving as a trustee and independent director, and advising companies, creditors and other parties-in-interest regarding bankruptcies, restructurings, acquisitions and dispositions.



Nicholas Kajon is Co-Chair of Stevens & Lee's Bankruptcy and Financial Restructuring Department and Co-Chair of its Litigation Finance and Alternative Funding Group. He advises clients on financial restructuring, corporate governance and commercial litigation matters, and has negotiated multi-million dollar agreements with litigation funders in insolvency and commercial litigation claims.

Burford Capital is a leading global finance firm focused on law. Its businesses include litigation finance and risk management, asset recovery and a wide range of legal finance and advisory activities. Burford is publicly traded on the London Stock Exchange, and it works with law firms and clients around the world from its principal offices in New York, London and Chicago.

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