Written Materials

Ethics of Buying Lawsuits and Claims in Bankruptcy

Ethical Issues in Purchasing Claims and Litigation in Bankruptcy Proceedings

In re Greenberg
266 B.R. 45 (Bankr. E.D.N.Y. 2001)

FACTS

- Robert Greenberg filed for chapter 7 bankruptcy; the only creditors who timely filed proofs of claim were Aljo and Chubb & Son (unsecured claims)
- Trustee filed two separate actions to recover alleged fraudulent conveyances by the debtor to his wife, Leslie
- The Trustee filed a proposed Stipulation and Settlement of all claims against Leslie for $150,000—there was a provision that the settlement included the avoidance actions
- Chubb objected to the Settlement and offered to pay the trustee $175,000 for an assignment of and the right to prosecute the avoidance action claims

ISSUE

Whether the primary creditor in a debtor's chapter 7 case may purchase from the trustee an assignment of his rights to pursue all existing or potential avoidance claims against the debtor's spouse

ARGUMENTS

- Chubb: (1) The trustee is wrong in his assessment of the merits of and defenses to the fraudulent conveyance claims; and (2) his offer is higher and better
- Leslie: (1) There is precedent that a trustee's avoidance powers are assets or property of the bankruptcy estate—therefore they cannot be assigned or sold

COURT'S RULING

- Chubb's offer to pay $175,000 to the estate in exchange for the right to pursue the claims is the proposal that best maximizes value for the estate
- Chubb entities represent 99% of all outstanding claims—this obviates the concern that one creditor might recover more than its fair share of assets in any subsequent action
- The appearance of impropriety is minimized in this case—Chubb holds 99% of the claims and the immediate benefit to the estate of $25,000 in excess of the original settlement offer clearly maximizes value for the estate
- The trustee's authority to pursue these claims may be properly assigned to Chubb provided that such authority is limited to the pursuit of claims on behalf of the estate and that any subsequent recovery is equitably distributed to Greenberg's creditors under the trustee's supervision
- Court grants Chubb's objection—the proposed settlement is denied

Cadle Co. v. Mims (In re Moore)
608 F.3d 253 (5th Cir. 2010)

FACTS

- Cadle Co. is the largest creditor of the bankruptcy estate of James Moore (86% of the unsecured debt)
- Cadle asserted claims of reverse veilpiercing and fraudulent conveyance
- Because Moore represented he had no assets for distribution, asset recovery litigation was the only potential means for creditors to receive any payment
- Cadle continued to fund the litigation after it came under the trustee's control
- As costs began to pile up, Cadle offered to purchase the claims from the trustee for $10,000; Cadle and the Trustee started negotiating
- Without informing Cadle, the Trustee proposed a settlement of the claims with the defendants for $37,500—Cadle found out and immediately offered $50,000 to pay for the claims

ISSUE

Whether a trustee in bankruptcy may sell causes of action that arise from the trustee's avoidance powers under section 544(b) of the Bankruptcy Code

Whether the proposed settlement of an avoidance action should be scrutinized under section 363(b) as well as Rule 9019 of the Federal Rules of Bankruptcy Procedure because a creditor offered to purchase the claim for more than the proposed settlement amount

ARGUMENTS

- Cadle: (1) The proposed settlement was essentially a sale of estate assets so the trustee had a duty to maximize the value of the claims—therefore the trustee could not push through a settlement for a lessor amount than the major creditor was willing to pay the estate; and (2) it should be able to purchase the claims from the trustee and pursue them at its own risk and expense, paying the estate immediately for that right
- Trustee: (1) Proposed settlements need only be "reasonable"—bankruptcy courts should not consider overbids like Cadle's; and (2) the proposed settlement is a true compromise which the court should give effect to

COURT'S RULING

Reverse Veilpiercing Claims
- Under Texas state law, a reverse-piercing action belongs to the trustee, not to one individual creditor of the debtor
- Therefore, reverse veilpiercing claims brought by a creditor are considered property of the estate so the trustee may sell them pursuant to 11 U.S.C. § 363(b)

Fraudulent-Transfer Claims
- Under Texas state law, a fraudulent-conveyance action is property of the estate once bankruptcy is under way
- Therefore, fraudulent-transfer claims may be sold pursuant to § 363(b)

The Settlement
- Under Texas state law, it is up to the court's discretion whether an auction and § 363 sale is appropriate when an offeror makes a higher offer than the proposed settlement
- Therefore, the bankruptcy court's failure to consider an auction or sale, or other alternatives to the settlement, was an abuse of discretion

So, the bankruptcy court erred in ruling that the two claims could not be sold—its approval of the proposed settlement was an abuse of discretion

In re Int'l Oil Trading Co., LLC
548 B.R. 825 (Bankr. S.D. Fla. 2016)

FACTS

- Al-Saleh, a citizen of Jordan, and IOTC, an oil trading company, procured and executed contracts to transport fuel across Jordanian territory to Iraq
- The relationship soured and Al-Saleh sued IOTC
- Al-Saleh entered into a contractual relationship with Burford Capital to fund his litigation against IOTC
- Al-Saleh won a judgment against IOTC, yet was unable to collect his judgment despite numerous attempts—so he filed an involuntary bankruptcy petition while still being funded by Burford
- Now in bankruptcy court, IOTC sought to compel production of documents in discovery: (1) communications between Al-Saleh and Burford; and (2) the funding agreement between Al-Saleh and Burford
- Al-Saleh objected to these requests

ISSUE

Whether communications and a funding agreement between a litigation funder and their client are privileged and therefore protected from discovery

RELEVANT AUTHORITY

Florida Statute § 90.502

(c) A communication between lawyer and client is "confidential" if it is not intended to be disclosed to third persons other than:

1. Those to whom disclosure is in furtherance of the rendition of legal services to the client.

2. Those reasonably necessary for the transmission of the communication.

ARGUMENTS

- Al-Saleh: (1) Both the funding agreement and the Burford communications are protected from discovery due to attorney-client privilege; (2) Both the funding agreement and the Burford communications are protected from discovery because it is considered work-product
- IOTC: (1) Attorney-client privilege does not apply to communications with litigation funders and their clients; (2) work product doctrine does not apply to communications with litigation funders and their clients and even if it does apply, IOTC has a substantial need and would be unable to obtain the same information elsewhere

COURT'S RULING

Under federal and Florida law, attorney-client privilege applies only to communications, not to contracts—therefore the funding agreement does not fall under attorney-client privilege

The court finds that the Burford communications are protected by both the common interest exception and the agency exception

Common Interest Exception
- Al-Saleh's disclosures to Burford were necessary to obtain informed legal advice on how to prosecute and fund a collection action—since the disclosures were in assistance of their common cause, all communications among Burford, Al-Saleh and his counsel are protected from discovery as they are subject to the attorney-client privilege as a result of application of the common interest exception

Agency Exception
- Agency exception is intended to protect communications with any party who assists the client in obtaining legal services—litigation funders fall in this category
- Communications with a litigation funder fall within the exception for the very reason litigation funders exist—without litigation funders, parties owed money, or otherwise stymied by deep-pocketed judgment debtors, might have reduced or no ability to pursue
- Al-Saleh has engaged Burford in furtherance of the rendition of legal services—therefore, all communications among Burford, Al-Saleh and his counsel are subject to attorney-client privilege as a result of the agency exception

COURT'S RULING (cont'd)

Work Product—Communications
- Al-Saleh's purpose in communicating with Burford was to pursue and fund his litigation efforts—each link in that chain is in furtherance of rendition of legal services
- Litigation was ongoing at all relevant times—absent such litigation, there would be no motivation for Al-Saleh to communicate with Burford; therefore the communications, in furtherance of his litigation, is privileged

Work Product—Funding Agreement
- Although the funding agreement itself is work-product, as it was entered into with the intent to facilitate litigation, IOTC has demonstrated a substantial need for it and that it will suffer an undue burden as the agreement is central to one of its theories
- The Court requires Al-Saleh to produce the Funding Agreement, however, Al-Saleh may redact the terms of payment and any terms he reasonably believes may disclose mental impressions

In re DesignLine Corp.

Nos. 13-31943, 13-31944, 2017 Bankr. LEXIS 182 (U.S. Bankr. W.D.N.C. Jan. 20, 2017)

FACTS

- Debtors were a former hybrid bus company that filed for bankruptcy
- The debtors' assets consisted primarily of un-asserted causes of action—the trustee pursued most, but three actions against debtors' former officers and directors remained (Insider Actions)
- The defendants in the Insider Actions had insurance policies to cover the litigation; the trustee began to investigate how to fund her side of the litigation
- The trustee secured RDSL, an affiliate of Parabellum Capital LLC, to fund the litigation—they entered into a litigation funding agreement
- Per the agreement, RDSL is to advance the costs of litigating the Insider Actions on a quarterly basis—if the trustee succeeds in actions during this time, RDSL is repaid its advances and substantial interest in the remaining proceeds of those actions

ISSUE

Whether a trustee can enter into a litigation funding agreement with a third party litigation funder, to pursue causes of actions beneficial to the estate, without engaging in champerty

ARGUMENTS

- Opponents: (1) The "sale" of the proceeds after successfully litigating is illusory in that RDSL has no affirmative duty to continue to fund and is essentially paying a "purchase price" it will receive back in full; and (2) The agreement violates North Carolina law because RDSL would exercise sufficient control over the litigation so as to constitute champerty
- Trustee: (1) Without the funding agreement, she will not be able to continue to litigate the Insider Actions and, as a result, creditors will lose their only chance at recovery in this bankruptcy; (2) The funding agreement falls within the the broadly worded provisions of the bankruptcy plan to sell trust assets; and (3) She is not engaging in champerty—RDSL has no control over the litigation and would be but a passive onlooker

COURT'S RULING

- The litigation funding agreement is champertous and violates North Carolina public policy
- Here, the litigation funder is not passive—the trustee is required to make regular funding requests upon RDSL as the litigation progresses and seek its input and approval of strategic decisions
- RDSL has the ultimate power to cut off funding and control the litigation—this directly affects how the trustee and the firms prosecute the Insider Actions and constitutes champerty under North Carolina law
- Because the court cannot approve an agreement that violates public policy, the trustee's motion is denied

In re Cybergenics Corp.

226 F.3d 237 (3d Cir. 2000)

FACTS

- Cybergenics Corporation filed for chapter 11 bankruptcy after being sold in a leveraged buyout and then burdened with more than $60 million in debt
- Shortly after filing, Cybergenics entered into an agreement to sell nearly all of its assets to a third party for $2.5 million—it was eventually sold at auction for $2.65 million
- Cybergenics then moved to dismiss its bankruptcy case—the unsecured creditors committee objected, contending that the leveraged buyout could give rise to avoidance actions that Cybergenics could bring on behalf of the bankruptcy estate in its capacity as debtor in possession
- Arguing that avoidance actions would benefit the estate, the committee sought to bring fraudulent transfer actions on behalf of the estate

ISSUE

Whether certain fraudulent transfer claims arising from transfers made by a debtor were included in a sale of all assets of the debtor so as to foreclose its creditors from thereafter pursuing those claims on behalf of its bankruptcy estate

RELEVANT AUTHORITY

New Jersey Uniform Fraudulent Transfer Act

N.J. STAT. ANN. § 25:2-25:

> A transfer is made or an obligation incurred by a debtor *is fraudulent as to the creditor*, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation

ARGUMENTS

- Committee: (1) The fraudulent transfer claims which arose from transfers made and obligations incurred by Cybergenics in the leveraged buyout are not assets of Cybergenics and therefore were not sold in the asset sale
- Defendants: (1) The committee cannot bring the action because the claims asserted had been sold in the asset sale

COURT'S RULING

- Under New Jersey state law, a fraudulent transfer claim arising from a debtor's transfers and obligations belongs to the creditors, not the debtor (NJ Statute)—therefore, neither the fraudulent transfer claim nor the avoidance power was an asset of Cybergenics that was sold
- If the fraudulent transfer claim had been an asset of Cybergenics, it should have been reflected as an asset on Cybergenics' bankruptcy schedules—it was not so listed
- There is no evidence that the purchaser of Cybergenics' assets ever took the position that he bought the fraudulent transfer claims or the power to avoid the transfers provided by the Bankruptcy Code
- In cases like this, courts should focus on whether the actions ever belonged to the debtor in the first place—not when they arose and whether they were transferable as a general matter

In re Boyer
372 B.R. 102 (D. Conn. 2007)

FACTS

- Boyer (debtor) filed for chapter 7 bankruptcy—two years later, Republic Credit Corporation (unsecured creditor) filed a complaint against Boyer seeking a denial of discharge
- Republic's complaint alleged the debtor had maintained a secret interest in real and personal property that he transferred to his wife, Mary
- The trustee sought to place a constructive trust on the assets transferred to Mary—Mary offered to settle the constructive trust claims for $85,000
- Republic objected to the compromise and offered to purchase all of the constructive trust claims from the trustee for $90,000
- The trustee, determining that the bankruptcy court would not approve the sale to Republic, presented only Mary's offer to the bankruptcy court
- Republic made an additional offer which included an additional 10% payment to the estate—the trustee did not respond
- The bankruptcy court approved the settlement between trustee and Mary —Republic appealed

ISSUE

Whether a court should approve a settlement of constructive trust claims between the trustee and the debtor's wife if a creditor offers to purchase all of the constructive trust claims at a higher amount than the settlement proposal.

ARGUMENTS

- Republic: (1) The court improperly approved the settlement because they had submitted higher settlement offers to the trustee who declined to submit the offers to the court for approval
- Trustee: (1) The settlement was reasonable; (2) the constructive trust claims otherwise had little value; (3) the debtor probably had not engaged in any fraudulent transfers—so, settlement was proper

COURT'S RULING

- The court agrees with the bankruptcy court that constructive trust claims are sufficiently analogous to avoidance claims such that the same rules should apply to assignments of both
- It is feared that by allowing one creditor to buy a claim from the trustee and pursue that claim on his own behalf, that creditor may be allowed to recover more of the estate's assets than would otherwise rightfully be due to that creditor
- So, the bankruptcy court was correct to not approve Republic's offer because at no time did it seek to pursue the claims entirely on the estate's behalf
- The bankruptcy court correctly concluded that the trustee could not have abandoned the constructive trust claims because Mary's offer to purchase them established that they were valuable to the estate
- The bankruptcy court properly approved the trustee's settlement with Mary

In re Metro. Elec. Mfg. Co.
295 B.R. 7 (Bankr. E.D.N.Y. 2003)

FACTS

- The debtor was a corporation that filed for chapter 11 bankruptcy
- The corporation was owned 50% by "Joseph Shelley Owners" and 50% by "James Shelley Owners"
- As a result of the pending bankruptcy, all litigation against the debtor was stayed—including a shareholder derivative action commenced by Joseph Shelley Owners against the James Shelley Owners
- The trustee filed an application to approve the sale of substantially all of the assets of the debtor to Switchboard, subject to higher or better offers
- The purchase agreement excluded "all of the rights and claims of seller for avoidance actions available to seller under the Bankruptcy Code . . . and any related claims and actions . . .
- After the agreement was approved, the trustee filed an application to sell to Joseph Shelley all of the claims excluded from the purchase agreement—claims the trustee believes have little value
- Joseph Shelley offered to purchase the trustee's rights where the estate would receive the purchase price, but if there was any other recovery, it would belong to the estate—Switchboard objected

ISSUE

Whether a shareholder of a debtor may purchase from the trustee an assignment of his rights to pursue certain avoidance claims where the trustee will not be taking part in the litigation and the benefit to the estate is limited to the purchase price

ARGUMENTS

- Shelley: (1) The avoidance actions were excluded from the asset sale so he has the right to purchase the claims and pursue them on his own
- Switchboard: (1) The proposed sale violates the Bankruptcy Code and applicable case law

COURT'S RULING

- Selling the claims is not in the best interest of the estate—the trustee already investigated the claims and decided that bringing the suits was not in the best interest of the estate; by contrast, Shelley never investigated the claims before offering to purchase them
- If the outright purchase of the trustee's statutory rights are allowed, Joseph Shelley will use the trustee's rights to further his own agenda and it will not benefit the debtor's estate
- If Joseph Shelley is permitted to purchase the trustee's rights and pursue the alleged wrongdoers, there will be no end in sight to litigation and the only benefit to the estate is the purchase price
- Putting an end to litigation in this bankruptcy case and distributing the funds available to creditors is in the best interests of this estate, and the benefit far outweighs any benefit in selling the trustee's rights

Bluebird Partners, L.P. v. First Fid. Bank, N.A.

94 N.Y.2d 726, 709 N.Y.S.2d 865, 731 N.E.2d 581 (2000)

FACTS

- In 1987, Continental and four trustees entered into a Secured Equipment Indenture and Lease Agreement, in which Continental issued a $350 million debt offering, secured by collateral—consisting of three series of certificates (UJB held second series certificate)
- The three series of certificates would be prioritized with the first series having priority over the second series, and the second series having priority over the third series
- Continental filed for bankruptcy in 1990—at that time, there existed a total outstanding obligation pursuant to the three certificate offerings of of over $180 million
- UJB filed a priority action to declare that all certificate holders would share equally in all consideration received by the trustee, rather than in declining order
- Bluebird Partners, an affiliate of Gabriel Capital, purchased $70 million worth of Continental's outstanding first series certificates at a price of $26 million and $1.8 million worth of Continental's outstanding second series certificates at a price of $4,500
- When Continental emerged from bankruptcy, the value of their collateral was not enough to compensate fully even the first series of certificate holders
- Bluebird then sued UJB and trustees for breach of fiduciary duty in its failure to ensure compensation for the certificate holders

ISSUE

Whether the purchase of a second series certificate is champertous if the purchaser subsequently files a lawsuit based on the failure to prioritize the certificates in a fashion where all series of certificates would be compensated

RELEVANT AUTHORITY

NY CLS Jud § 489 (Champerty Statute)

"No person or co-partnership, engaged directly or indirectly in the business of collection and adjustment of claims, and no corporation or association, directly or indirectly, itself or by or through its officers, agents or employees, shall solicit, buy or take an assignment of, or be in any manner interested in buying or taking an assignment of a bond, promissory note, bill of exchange, book debt, or other thing in action, or any claim or demand, *with the intent and for the purpose of bringing an action or proceeding thereon*"

ARGUMENTS

- Bluebird: (1) They had valid business reasons for making the second series purchases; (2) the primary purpose of purchase was not to sue on the certificates; (3) there are issues of fact regarding the champerty defense
- UJB: (1) Bluebird's purchase is champertous because its primary purpose in purchasing the second series certificates—not sole purpose—was to file a lawsuit

COURT'S RULING

- To constitute champertous conduct, the foundational intent to sue on that claim must at least have been the primary purpose for, if not the sole motivation behind, entering into the transaction
- Since Bluebird purchased the second series certificates in their entirety, and not just the rights to a lawsuit encompassed within the expressed terms of the instrument, it is impossible to discern that there was a sole purpose or even a primary purpose—there are still questions of fact
- There are sufficient business motivations for the purchase of the certificates: (1) there was an array of financial considerations; (2) there was an intent to be paid on the certificates; and (3) Bluebird could have been covering varying risks and potentialities
- Bluebird first sued UJB based on its conduct during the Continental bankruptcy before payment on the second series certificates was possible—neither the success of the priority action nor a profit or loss on the second series certificates was yet known; so, it appears the lawsuits were hardly incidental to or contingent on the settlement of the priority action or the outcome of the bankruptcy appeal
- The decision to sue cannot automatically become synonymous with champerty—litigation can be appropriate and commonly used strategy
- UJB's motion to dismiss Bluebird's complaint on champerty grounds is denied

In re Lynn

285 B.R. 858 (Bankr. S.D.N.Y. 2002)

FACTS

- Lynn (debtor) is moving to invalidate the assignment of a claim in his chapter 7 case from Nationwide Auction to Goyakla, on the ground that Goyakla's principal, Silverman (an attorney), engaged in champerty
- Silverman purchased a unit in Lynn's condominium; during Lynn's bankruptcy proceeding, Silverman provided the trustee and then the FBI with information regarding the value of the condominium—alleging Lynn committed bankruptcy fraud
- When Lynn filed for bankruptcy, Goyakla (aka Silverman) paid $50 for the unsecured claim from Nationwide which was worth $177,107.50
- Since buying the claim, Silverman has (1) tried to get the trustee to reopen the second settlement with Lynn because of the condominium valuation issues; and (2) spoke as a victim of Lynn's bankruptcy fraud at Lynn's sentencing hearing (pled guilty to bankruptcy fraud)
- Lynn is seeking to invalidate Silverman's claim assignment

ISSUE

Whether a debtor can invalidate a claim assignment by establishing the claim purchaser engaged in champerty

RELEVANT AUTHORITY

NY CLS Jud § 488 – Buying demands on which to bring an action

- An attorney or counselor shall not:
  1. Directly or indirectly, buy, take an assignment of or be in any manner interested in buying or taking an assignment of a bond, promissory note, bill of exchange, book debt, or other thing in action, with the intent and for the purpose of bringing an action thereon.
  2. By himself or herself, or by or in the name of another person, either before or after action brought, promise or give, or procure to be promised or given, a valuable consideration to any person, as an inducement to placing, or in consideration of having placed, in his or her hands, or in the hands of another person, a demand of any kind, for the purpose of bringing an action thereon, or of representing the claimant in the pursuit of any civil remedy for the recovery thereof

  . . .

  4. An attorney or counselor who violates the provisions of this section is guilty of a misdemeanor.

ARGUMENTS

- Silverman: (1) He bought Nationwide's claim to make a profit—not with the sole intention of litigating against Lynn; (2) He believed when he bought the claim that unsecured creditors would eventually recover from Lynn's estate significantly more than the $50 he bought the claim with; (3) He played no meaningful role in Lynn's bankruptcy other than purchasing the claim; and (4) His "hostile" actions actually benefitted the estate
- Lynn: (1) Silverman is guilty of champerty—Silverman's hostile actions towards Lynn is evidence that Silverman only bought the claim to harass and annoy Lynn in court

COURT'S RULING

- Lynn has not carried his burden that Silverman committed champerty
- Lynn has not established that Silverman's primary, if not exclusive, intention when buying the claim was to litigate and harass Lynn in the courts—Silverman bought the claim well before Lynn's criminal proceeding which exposed Lynn as committing bankruptcy fraud
- Silverman had not filed any pleading in the bankruptcy case—his involvement in the case is limited to his $50 purchase of the claim
- The court denies Lynn's motion to invalidate the claim assignment from Nationwide to Silverman

Duckor Spradling & Metzger v. Baum Trust (In re P.R.T.C., Inc.)

177 F.3d 774 (9th Cir. 1999)

FACTS

- PRTC and BIC filed chapter 7 bankruptcy petitions which were consolidated
- The trustees determined that the only significant assets were the right to avoid various transactions and the right to sue various individuals
- The trustees concluded that the estates lacked sufficient funds to pursue those claims or rights—so they assigned the claims and rights to Baum, the estate's largest creditor
- Under the assignment, Baum "shall have the right at its sole discretion to pursue, not pursue, settle, compromise or collect upon such Collective Claims or Rights"
- The debtor objected to this assignment

ISSUE

Whether a trustee can assign its rights to pursue avoidance actions for the benefit of both creditors and the estate when the estate lacks sufficient funds for the trustee to pursue the actions itself

ARGUMENTS

- Debtor: (1) Trustees cannot transfer to a creditor their rights to sue various defendants and to avoid various transactions; (2) Avoidance powers cannot be assigned to someone other than the debtor or trustee because the trustees did not transfer their avoidance powers pursuant to a Chapter 11 reorganization plan; (3) Precedent allows a trustee to transfer—not necessarily Chapter 7 trustees; and (4) Baum is not a disinterested person and therefore cannot assume trustee powers

COURT'S RULING

- Avoidance powers may be assigned to someone other than the debtor or trustee pursuant to a plan of reorganization—it doesn't matter if it is a Chapter 7 or Chapter 11 reorganization
- Baum is pursuing the interest of all creditors—under the assignment agreement, Baum can pursue both its individual claims and the estate's collective claims; if Baum prevails on any of these, 50% of the net proceeds go to remaining creditors
- Out of all the options available to the court, this transfer was the best option to potentially provide the remaining creditors with any benefit
- The court affirms the transfer of avoidance powers from the trustee to Baum

Simantob v. Claims Prosecutor, L.L.C. (In re Lahijani),
25 B.R. 282 (B.A.P. 9th Cir. 2005)

FACTS

- Appellants Kamiar Simantob and Naseer Lahijani, sued the Debtor in a state court to recover $10 million for embezzlement before bankruptcy.
- The Debtor's bankruptcy case, earlier closed as a no-asset case, was reopened and a trustee was appointed.
- Kamiar and Naseer filed a proof of claim against the debtor in the amount $9,786,000 . (all claims total about $13 milllion)
- To maximize the value of the bankruptcy estate available for distribution to the creditors, Kamiar and Naseer offered 50% of net recoveries to purchase the Trustee's cause of action arising from his avoidance powers.
- The Debtor's brother in law and co-defendant formed a company called Claims Prosecutor, LLC in order to acquire the avoiding power causes of action, offering $ 30,000; later raised to $100,000.
- However, the trustee subsequently issued a supplemental notice of a contested sale hearing at which the estate property would be auctioned.

- At this auction, Kamiar and Naseer offered $160,000 (along with percentage recoveries) and Claims Prosecutor offered $175,000. As the Trustee resisted percentage recoveries option and wanted cash instead.
- In absence of the percentage option, the Claim Prosecutor was found as the highest bidder. The court authorized the Trustee to sell his cause of action to the Claims Prosecutor.
- Claims Prosecutor declined the court's offer to take testimony directed to the question of § 363(m) "good faith" and represented that the transaction would proceed without the benefit of a finding of "good faith.
- Kamiar and Naseer appealed the bankruptcy court's decision authorizing sale of Trustee's cause of action to the Claims Prosecutor in absence of the "good faith" finding.

ISSUE

1. Whether the court applied the correct legal standard when approving a § 363 sale of causes of action to a defendant for a sum certain over objections by the main creditor, who wanted to pursue the cause of action;
2. Whether the sale of causes of action to defendants in this instance met the requirements for approving a compromise as "fair and equitable".

ARGUMENTS

- Kamiar and Naseer argued that the cause of action arising out of Trustee's avoidance powers should not have been sold to Claims Prosecutor as it would not exercise the powers for the benefit of all creditors.
- Claims Prosecutor took the position that the Trustee's avoidance power causes of actions could be sold for the certain sum/fixed sale price and that it created greater benefit to the estate than the best offer of Kamiar and Nasir.

Viewed as a sale, the question, thus, boiled down to whether the sale price to Claims Prosecutor created a greater benefit to the estate than the best offer of appellants.

COURT'S RULING

- The Court agreed that the Trustee's avoiding powers may be transferred for a sum certain .
- The court noted that the fair and equitable settlement standard, originally established by the Supreme Court in *TMT Trailer Ferry*, requires consideration of:
  - (a) probability of success in the litigation;
  - (b) collectability;
  - (c) complexity, expense, inconvenience, and delay attendant to continued litigation; and
  - (d) the interests of creditors, which are said to be "paramount.
- The court held that, because the sale amounted to an acquisition of causes of action by a defendant, the sale had to be analyzed as a compromise as to which the bankruptcy court should have determined whether it was fair and equitable.
- The court also held that it was debatable that the amount offered by the Claims Prosecutor was actually the high bid in light of the offer of a percentage of the net litigation proceeds by creditors.
- The court reversed and remanded the bankruptcy court's decision.

Conclusion

- Trustee's avoiding powers may be sold for a sum certain.
- When a cause of action is being sold to a present or potential defendant over the objection of creditors, a bankruptcy court must, in addition to treating it as a sale, independently evaluate the transaction as a settlement under the prevailing "fair and equitable" test, and consider the possibility of authorizing the objecting creditors to prosecute the cause of action for the benefit of the estate as permitted by § 503(b)(3)(B).

Accrued Fin. Servs. v. Prime Retail, Inc., 298 F.3d 291 (4th Cir. 2002)

FACTS

- The plaintiff Accrued Financial Services (AFS) contracted with the defendant tenants ("tenants") to conduct audits of the tenants' leases and retained 40-50 percent of the discrepancies that the company discovered in leases at two factory outlet malls.
- Thereafter, instead of settling the discrepancies, AFS persuaded 16 other tenants to enter into similar contractual relationships with AFS and thereby launched a larger attack against the landlord.
- AFS then sued the landlord in its own name on behalf of the 17 tenants.

ISSUE

1. Whether the assignment of right to all legal claims by the tenants to AFS valid under Maryland law?

ARGUMENTS

- The landlord argued that AFS lacked standing and that the assignment of cause of action to AFS by the tenants was invalid as against public policy. The landlord therefore the lawsuit against the landlord was liable to be dismissed.
- AFS maintained a position that the assignment by the tenants was justified under the standard principles of assignment law, which recognize the legality of assigning both existing and potential choses in action, so long as the causes of action survive the death of the assignor.
- The district court granted the motion to dismiss on the landlord.
- AFS appealed the decision of the District Court.

COURT'S RULING

- The Court of Appeals for the Fourth Circuit found that because the tenants' broad assignments of their rights to all legal claims against the landlords to AFS were nothing more than arrangements through which AFS could intermeddle and stir up litigation for the purpose of making a profit, they violated Maryland's strong public policy against stirring up litigation and were therefore void and unenforceable in Maryland.
- AFS did not have a standing to bring the lawsuit against the landlord under Maryland laws.

Conclusion

- If the promoter or assignee of the rights to sue in a lawsuit is being benefitted rather than the litigation, the court may uphold the assignment as invalid and against public policy.